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IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

Vol. 3242

WILL FLITCROFT and AGNES D. FLITCROFT,

Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

---

BRIEF FOR APPELLANTS

---

ON PETITION  
FOR REVIEW OF DECISION OF  
THE TAX COURT OF THE UNITED STATES

---

ERNEST R. MORTENSON  
EUGENE HARPOLE

961 East Green Street  
Pasadena, California

Attorneys for Appellants





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BRIEF FOR APPELLANTS

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OPINION BELOW

The Opinion of the Tax Court was filed on October 9, 1962 and its decisions based upon said Opinion and whose review is sought, were entered on December 18, 1962, and December 20, 1962, respectively (R. 217-247, 258-261).

JURISDICTION

The Tax Court had jurisdiction of this matter under §7442 (26 USCA 7442) and §6213 of the Internal Revenue Code of 1954 (26 USCA 6213). This Court has jurisdiction under §7482 of the Internal Revenue Code of 1954 (26 USCA 7482).



This Petition for Review (R 262-266) involves deficiencies in the petitioners' Federal income taxes for the calendar years 1954, 1955 and 1955, respectively (R 16). The petitioners, Will Flitcroft and Agnes D. Flitcroft, were and are husband and wife with a place of residence in Los Angeles County, State of California (R. 55). They filed joint Federal income tax returns for the calendar years 1954, 1955 and 1956, with the District Director of Internal Revenue at Los Angeles, California, on the respective dates of April 15, 1955, April 16, 1956 and April 15, 1957 (R 55).

On March 11, 1959, the Commissioner of Internal Revenue mailed to the taxpayers by registered mail a Notice of Deficiency covering the calendar years 1953 and 1954 (R. 16). The taxpayers filed a Petition for Redetermination with the Tax Court on May 4, 1959 (R. 9).

On August 5, 1960, the Commissioner of Internal Revenue mailed to the taxpayers by registered mail a Notice of Deficiency covering the calendar years 1955 and 1956 (R. 36). The taxpayers filed a Petition for Redetermination with the Tax Court on September 6, 1960 (R. 31).

On October 9, 1962, the Tax Court filed its Opinion covering both Dockets No. 80074 and No. 88894 (R. 217). The Tax Court's decision covering the year 1954, whose review is sought, was entered December 18, 1962 (R. 258). Its decision covering the years 1955 and 1956, whose review is also sought was entered on December 20, 1962 (R. 260).

The case is brought to this Court by a Petition for Review





filed with the Tax Court on March 11, 1963 (R. 262) On March 11, 1963, the petitioners filed with the Clerk of the Tax Court and served upon the Attorney General, a Statement of Points Upon Which They Intend to Rely in this Review (R. 267)

Petitioners have designated the entire record of all the proceedings and evidence including exhibits as the record on review of the decision of the Tax Court (R. 270).

### STATUTES AND REGULATIONS INVOLVED

#### Section 191, Internal Revenue Code of 1939:

##### "FAMILY PARTNERSHIPS:

"In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service. For the purpose of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market





value of the purchased interest shall be considered to be donated capital. The 'family' of any individual shall include only his spouse, ancestors, and lineal descendants, and any trust for the primary benefit of such persons. "

Section 704 (e)(1)(2)(3), Internal Revenue Code of 1954:

"(e) Family Partnerships. -

"(1) Recognition of interest created by purchase or gift. -

"A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

"(2) Distributive share of donee includible in gross income. -

"In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.



"(3) Purchase of interest by member of family -

"For purposes of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The 'family' of any individual shall include only his spouse, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons. "

Section 162 (a)(3), Internal Revenue Code of 1954:

"(a) In General. - There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including -

"(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. "

Section 673 (a), Internal Revenue Code of 1954:

"REVERSIONARY INTERESTS.

"(a) General Rule. - The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom if, as of the inception of that portion of the trust, the interest will or may reasonably be expected to take effect in possession or enjoyment within 10 years





commencing with the date of the transfer of that portion of the trust. "

Section 676 (a), Internal Revenue Code of 1954:

"POWER TO REVOKE.

"(a) General Rule. - The Grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a non-adverse party, or both. "

Treasury Regulations 1.162-1:

"§1.162-1 Business expenses - (a) In general.

Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than section 162. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. See §1.61-3(a). Among the items included in business expenses are management expenses, commissions (but see section 263 and the regulations thereunder), labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business.



(see §1.162-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property "

Treasury Regulations 1.704-1(e)(vii):

"(vii) Trustees as partners.

A trustee may be recognized as a partner for income tax purposes under the principles relating to family partnerships generally as applied to the particular facts of the trust-partnership arrangement. A trustee who is unrelated to and independent of the grantor, and who participates as a partner and receives distribution of the income distributable to the trust, will ordinarily be recognized as the legal owner of the partnership interest which he holds in trust unless the grantor has retained controls inconsistent with such ownership. However, if the grantor is the trustee, or if the trustee is amenable to the will of the grantor, the provisions of the trust instrument (particularly as to whether the trustee is subject to the responsibilities of a fiduciary), the provisions of the partnership agreement, and the conduct of the parties must all be taken into account in determining whether the trustee in a fiduciary capacity has become the real owner of the partnership interest. Where the grantor (or person amenable to his will) is the trustee, the trust may be recognized as a partner only if the grantor (or such other person) in his participation in





the affairs of the partnership actively represents and protects the interests of the beneficiaries in accordance with the obligations of a fiduciary and does not subordinate such interests to the interests of the grantor. Furthermore, if the grantor (or person amenable to his will) is the trustee, the following factors will be given particular consideration:

"(a) Whether the trust is recognized as a partner in business dealings with customers and creditors, and

"(b) Whether, if any amount of the partnership income is not properly retained for the reasonable needs of the business, the trust's share of such amount is distributed to the trust annually and paid to the beneficiaries or reinvested with regard solely to the interests of the beneficiaries."

Treasury Regulations 118, §39.22(a)-21(c):

"Reversionary interest after a relatively short term. (1) Income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or the income therefrom which will or may reasonably be expected to take effect in possession or enjoyment:

"(i) Within 10 years commencing with the date of the transfer, or \* \* \* \*

Section 2250, Civil Code of California:

"Who are trustees within scope of this chapter.

"The provisions of this chapter apply only to express trusts, created for the benefit of another than the trustor,



and in which the title to the trust property is vested in the trustee; not including, however, those of executors, administrators, and guardians, as such. "

Section 2280, Civil Code of California:

"REVOCATION OF TRUSTS.

"Unless expressly made irrevocable by the instrument creating the trust, every voluntary trust shall be revocable by the trustor by writing filed with the trustee. When a voluntary trust is revoked by the trustor, the trustee shall transfer to the trustor its full title to the trust estate. Trusts created prior to the date when this act shall become a law shall not be affected hereby. "

Section 1614, Civil Code of California:

"WRITTEN INSTRUMENT PRESUMPTIVE  
EVIDENCE OF CONSIDERATION.

"A written instrument is presumptive evidence of a consideration. "

Section 1689, Civil Code of California:

"WHEN PARTY TO A CONTRACT MAY RESCIND.

"A party to a contract may rescind the same in the following cases only:

"1. If the consent of the party rescinding, or of any party jointly contracting with him, was given by mistake, or obtained through duress, menace, fraud, or undue influence, exercised by or with the connivance of the party as to whom he rescinds, or of any other party to the





contract jointly interested with such party;

"2. If, through the fault of the party as to whom he rescinds, the consideration for his obligation fails, in whole or in part;

"3. If such consideration becomes entirely void from any cause;

"4. If such consideration, before it is rendered to him, fails in a material respect, for any cause;

"5. By consent of all the other parties; or

"6. Under the circumstances provided for in sections 1785 and 1789 of this code. "

Section 1691(2), Civil Code of California:

"RESCISSION, HOW EFFECTED.

"2. He must restore to the other party everything of value which he has received from him under the contract; or must offer to restore the same, upon condition that such party shall do likewise, unless the latter is unable or positively refuses to do so. "

Section 3399, Civil Code of California:

"WHEN CONTRACT MAY BE REVISED.

"When, through fraud or a mutual mistake of the parties, or a mistake of one party, which the other at the time knew or suspected, a written contract does not truly express the intention of the parties, it may be revised, on the application of a party aggrieved, so as to express that intention, so far as it can be done without prejudice to



rights acquired by third persons, in good faith and for value. "

Section 1060, California Code of Civil Procedure:

"DECLARATORY RELIEF

"Any person interested under a deed, will or other written instrument, or under a contract, or who desires a declaration of his rights or duties with respect to another, or in respect to, in, over or upon property, or with respect to the location of the natural channel of a watercourse, may, in cases of actual controversy, relating to the legal rights and duties of the respective parties, bring an action in the superior court for a declaration of his rights and duties in the premises, including a determination of any question of construction or validity arising under such instrument or contract. He may ask for a declaration of rights or duties, either alone or with other relief; and the court may make a binding declaration of such rights or duties, whether or not further relief is or could be claimed at the time. The declaration may be either affirmative or negative in form and effect, and such declaration shall have the force of a final judgment. Such declaration may be had before there has been any breach of the obligation in respect to which said declaration is sought. "

Section 1061, California Code of Civil Procedure:

"POWER NOT EXERCISED WHEN.

"The Court may refuse to exercise the power





granted by this chapter in any case where its declaration or determination is not necessary or proper at the time under all the circumstances. "

Section 1962(2), California Code of Civil Procedure

"SPECIFICATION OF CONCLUSIVE  
PRESUMPTIONS.

"The following presumptions, and no others, are deemed conclusive:

"2. The truth of the facts recited, from the recital in a written instrument between the parties thereto, or their successors in interest by a subsequent title; but this rule does not apply to the recital of a consideration. "

Section 1963(39), California Code of Civil Procedure:

"DISPUTABLE PRESUMPTIONS.

"39. That there was a good and sufficient consideration for a written contract. "

QUESTIONS PRESENTED

I.

SHOULD THE INCOME OF TRUSTS THAT HAD ALWAYS BEEN FOR A TERM IN EXCESS OF TEN YEARS AND WHICH WERE EXPRESSLY IRREVOCABLE TRUSTS DURING THE CALENDAR YEARS OF 1954, 1955 AND 1956 INVOLVED IN THIS PROCEEDING BE TAXED TO THE GRANTORS OF THOSE TRUSTS?



## II.

WERE THE TRUSTS CREATED BY THE TAXPAYERS FOR THEIR TWO CHILDREN, WILLIAM R FLITCROFT AND JOHNEL ANN FLITCROFT UNDER DATE OF JANUARY 1, 1953 REVOCABLE UNDER THE REVISIONS OF §2280 OF THE CIVIL CODE OF CALIFORNIA?

## III.

WAS THE CO-PARTNERSHIP, WESTERN HYDRAULIC AND SERVICE COMPANY, ENTITLED TO DEDUCT THE RENTALS PAID TO A TRUST CREATED BY THE TAXPAYERS FOR THEIR TWO CHILDREN ON OCTOBER 1, 1953 FOR THE USE OF ITS BUSINESS PROPERTY DURING THE CALENDAR YEARS 1954, 1955 AND 1956 FROM THE PARTNERSHIP GROSS INCOME OF THOSE YEARS FOR INCOME TAX PURPOSES?

## STATEMENT

The Government conceded and the Tax Court has held that the Commissioner's determination of a deficiency in taxpayers' income taxes for the calendar year 1953 was barred by the statute of limitations when made (R. 218). No issue is presented in this appeal as to the calendar year 1953.

The Commissioner determined a deficiency in the taxpayers' income tax for the calendar year 1954 of \$39,281.86 and sent a notice of the deficiency to the taxpayers by registered mail on





March 11, 1959 (R. 16). The Commissioner determined deficiencies in taxpayers' income tax for the calendar years 1955 and 1956 in the amounts of \$25,666.01 and \$31,047.73, respectively, and sent notice of the deficiencies to the taxpayers by registered mail on August 5, 1960 (R. 36). In the statements attached to the respective deficiency notices the following explanations appear:

"In the determination of your income it is held that the partnership, transacting business under the fictitious name of Western Hydraulic & Service Company, 1510 West 135th Street, Gardena, California, and allegedly entered into on or about January 1, 1953 by you and Richard H. Miers, as trustees for your minor daughter, Johnel A. Flitcroft, and your minor son, William R. Flitcroft, is not effective for income tax purposes. Accordingly, your unreported distributive share of net earnings from said partnership of \$37,232.79 in 1955 and \$45,395.93 in 1956 have been included in your returns for the respective taxable years.

"It is also held that the rent paid by the partnership transacting business under the fictitious name of Western Hydraulic & Service Company to the Johnel Ann and William R. Flitcroft Trust, in the amount of \$11,520 in 1955 and \$11,520 in 1956, is not a deductible business expense of the partnership. Accordingly, these amounts have been included in the earnings of the partnership and in your distributive share of the partnership earnings in the years



1955 and 1956.

"In the distribution shown above, it is held that the income of the Western Hydraulic & Service Company partnership is distributable 50% each to Will Flitcroft and Agnes D. Flitcroft. It is determined that no recognition should be given to the alleged partnership interests of the trusts created for William R. Flitcroft and Johnel A. Flitcroft, minor son and daughter of Will Flitcroft and Agnes D. Flitcroft.

"Ordinary net income of the partnership is increased \$11,520.00, as a result of a determination that rent in the amount of \$11,250.00 paid by the partnership to the Johnel A. Flitcroft and William R. Flitcroft Trust, minor daughter and son of Will Flitcroft and Agnes D. Flitcroft, is not a deductible business expense of the partnership." (R. 37).

The petitions which the taxpayers filed in the Tax Court allege that the Commissioner erred in taxing the entire income of the partnership, Western Hydraulic and Service Company, to them and also in refusing to allow the partnership a deduction for the rent paid to the William R. Flitcroft and Johnel Ann Flitcroft Trust during the taxable years here involved (R. 9-15, 31-34). The Commissioner's answers denied said allegations of error (R. 26-30, 43-44). The Tax Court sustained the Commissioner's determination on both issues (R. 217-247). The taxpayers seek a





review of the Tax Court's decision.

The Tax Court found as facts, that the petitioners, as partners, operated the business of Western Hydraulic & Service Company during the years 1946 through 1952 (R. 219). That Will Flitcroft managed the Company, functioned as Chief of Quality Control, did all of the purchasing of materials, machinery, and tools, did the bidding for customers, and kept up customer relations, as well as supervised production. In the performance of these duties Will Flitcroft worked long hours, six days and sometimes seven days a week (R. 220). Will Flitcroft testified that the long hours of work were breaking down his health (R. 77).

The Tax Court found as a fact that in June, 1952, the petitioner, Will Flitcroft, became acquainted with Richard H Miers who was then doing a running audit of the partnership's books. About July, 1952, Will Flitcroft engaged Miers to keep the books and records of the partnership at the prevailing fee of \$60 per day for his services (R. 220). Will Flitcroft testified that Miers was quite young and a very efficient boy at that time (R. 77). The Tax Court found that after Western Hydraulic engaged Miers to render accounting services for it, petitioner Will Flitcroft and Miers discussed from time to time the advantages which petitioners might derive through the creation of trusts for the benefit of their two minor children and the inclusion of these trusts in the partnership (R. 78). It was the finding of the Tax Court that the petitioners executed an agreement dated December 31, 1952 dissolving the partnership, Western Hydraulic & Service Company, then existing



between the appellants (R. 221) The Tax Court found that the petitioners and Miers, sometime after January 1, 1953, executed two written trust agreements dated January 1, 1953, Article 7 of which provided:

"This Trust has been accepted by the Trustee and will be administered in the State of California, and its validity, construction and all rights thereunder shall be governed by the laws of that State. If any provision of this Trust Agreement should be invalid or unenforceable, the remaining provisions thereof shall continue to be fully effective." (R. 221).

Will Flitcroft, one of the trustors, and Richard H. Miers, the trustee, each testified that it was decided the Trust Agreements should go into effect as of January 1, 1953 (R. 18, 122). The Tax Court found that the decision to form said two trusts was reached at a meeting held at the petitioners' home in November, 1952, at which the petitioners, their children aged 10 and 12 years, Richard H. Miers and an attorney were present. The Trust Agreements provided that the two trusts should cease and terminate on January 6, 1963 (R. 221, 222).

The Tax Court further found as a fact that at the same time that the Trust Agreements were executed petitioners and Miers, as trustee, for each of the two trusts, executed an agreement entitled "Agreement of Partnership" which agreement stated that it was made the first day of January, 1953 and provided that the name of



the partnership should be Western Hydraulic and Service Company, that the term of the partnership should begin on January 1, 1953 and should end on December 31, 1963 (R 223) Respondent's counsel stated at the trial that there was no dispute as to the date of the execution of the Partnership Agreement.

Richard H. Miers, the trustee, gave the following testimony concerning the history of the trusts: " \* \* \* so I volunteered my services and Mr. Flitcroft took me up on it. And we devised the trusts, set up the partnership, primarily for expansion purposes so that we could expand the operation. Western Hydraulic was a captive company of Douglas Aircraft at the time, doing better than 99 per cent of their business with the Douglas Aircraft Company and Douglas is a very peculiar company. Like any major prime contractor, if you can't take care of the business that they offer you, then you're sort of low on the totem pole. So we had no alternative excepting to go ahead. And this is how the trusts started and the move to 135th Street came about." (R. 87-88)

The Trust Agreements each recite that the transfers to the trustee were made without any consideration on the trustor's part (Exh. 5, 6).

The Agreement of Partnership provided that the capital contribution should consist of the assets subject to the liabilities as shown on an attached statement of assets and liabilities (Exh 17).

The Tax Court drew a conclusion of law from the evidence that the transactions were not shams, that independent trustees controlled the trust corpus, and that petitioners recognized the





trusts as partners and gave public notice of such recognition by the filing of a Certificate of Business Fictitious Firm Name listing the trusts as partners. It was further concluded by the Tax Court that the partnership agreement and trust agreements all dated January 1, 1953 were part of the same transaction and were required to be read together and that when this was done there was clearly a transfer of the trust corpus of the two individual trusts to the trustee and the designation of the trust corpus is clear (R. 234). The Tax Court found as a fact that capital was a material income-producing factor in the partnership, Western Hydraulic (R. 225)

Among other facts found by the Tax Court were the following:

Petitioner, Will Flitcroft, had also concluded that it would be advantageous to have Miers do the accounting work for Western Hydraulic and to help operate the business. During the years 1953 through 1956 Miers spent most of his time in connection with the business of Western Hydraulic. He took charge of production control, accounting, contract negotiations, renegotiation of government contracts and cost records. He also handled labor relations for the partnership and served as its controller, as well as working with the sales and engineering departments on the submission of bids for contracts. He hired office personnel and dealt directly with customers of Western Hydraulic (R. 225, 226).

The Tax Court found as a fact that during the years 1953 through 1956 Miers was paid a fee of \$60.00 per day or approximately \$900.00 per month for the services he rendered Western Hydraulic (R. 226). Miers testified that this was the prevailing



accounting fee at that time (R. 187) Miers is shown by the testimony in the record not to have received any fringe benefits from Western Hydraulic (R. 124) The Trust Agreements (Exhs 5 and 6, Stip. Facts) did provide in Article VI a fee based on a percentage of the income of the trust for his services (Exhs 5, 6)

The Tax Court concluded as a matter of law that "the evidence failed to show any benefit to petitioners of Miers' work for Western Hydraulic which was different after the creation of the trusts from before. Both before and after the creation of the trusts Miers did work of an accounting nature for Western Hydraulic at a fee of \$60.00 per day. The record does not show any other activities engaged in by Miers in connection with the partnership except his consultation on partnership matters with petitioners; there is no evidence to show that such consultations were of any benefit to petitioners or that they were not solely in the interests of the trusts. The evidence shows that the trusts were voluntary express trusts for the benefit of petitioners' minor children Cf. George S. Gaylord, CA-9 (1946), 153 F 2d 408, affirming 3 T. C. 281, and Erik Krag (1947), 8 T. C. 1091." (R. 239).

As originally written the Trust Agreements did not expressly provide that the trusts were irrevocable (Exhs 5, 6). The petitioners have never received any income from the trusts (R 82, 230).

The petitioner, Will Flitcroft, testified that the two trusts formed on January 1, 1953, were to be ten year irrevocable trusts (R. 84). Richard H. Miers, the trustee, testified that it was





intended that irrevocable trusts be created (R. 194) Frederick L. Botsford, a witness for the Respondent, an attorney licensed to practice law in California, who represented Mr. and Mrs. Flitcroft (R. 202), who prepared the trust agreements dated January 1, 1953 (R. 202), and was later a co-trustee and still was at the time of trial before the Tax Court (R. 211), verified the complaint in an action hereinafter described, entitled Botsford, et al. v. Will Flitcroft, Agnes D. Flitcroft and Robert A. Riddell, District Director of Internal Revenue, in which Complaint it was alleged:

"That Defendants Will Flitcroft and Agnes D. Flitcroft executed two Trust instruments dated the 1st day of January, 1953, of which Exhibits "A" and "B" attached hereto are copies, in which instruments Plaintiff Richard H. Miers was appointed Trustee.

"That it was intended by all parties, Article I of the Trust Agreements should read as follows:

'The Trustors shall have the right at any time, to add to this Trust other property acceptable to the Trustee, which additional property, upon its receipt and acceptance by the Trustee, shall become a part of the Trust Estate. This Trust is irrevocable.'

"The scrivener, by mistake, omitted to include in Article I above, the sentence:

'This trust is irrevocable.'

"That Plaintiffs, relying upon the accuracy of the scrivener, did not discover this omission until their



attention was drawn thereto several months later." (Exh. 11)

Upon discovery of the scrivener's mistake the parties to the Trust Agreements amended each of them on the 30th day of July, 1954, by adding thereto, the words "This trust is by the trustors, hereby expressly made irrevocable" (Exh. 11, pp. 25, 26).

On or about November 7, 1958, Frederick L. Botsford and Richard H. Miers, as trustees of the Flitcroft Trusts, Johnel A. Flitcroft and William R. Flitcroft, minors, by James Stevens, their Guardian Ad Litem, as plaintiffs, commenced an action in the Superior Court of the State of California in and for the County of Los Angeles, against William R. Flitcroft, Agnes D. Flitcroft and Robert A. Riddell, District Director of Internal Revenue (Exh. 11).

The Complaint filed, alleged, among other things, that it was intended by all parties to the Trust Agreements dated January 1, 1953, that Article I of the Trust Agreements should read as follows:

"The Trustors shall have the right at any time to add to this Trust other property acceptable to the Trustee, which additional property, upon its receipt and acceptance by the Trustee, shall become a part of the Trust Estate.

This Trust is Irrevocable." (Exh. 11).

The Complaint prayed for the following relief:

"For costs of suit and for such further and other relief as to this Court may seem just in the premises." (Exh. 11).



The Defendant, Robert A. Riddell, District Director of Internal Revenue, petitioned for a removal of the action to the United States District Court for the Southern District of California (Exh. 11, p. 3). In the United States District Court the Defendant, Robert A. Riddell made a Motion to Dismiss the action as to himself on the grounds:

1. That the Court lacks jurisdiction over the person of this defendant.
  2. That the Complaint does not state a claim upon which relief can be granted as to this defendant.
- (Exh. 11, p. 33).

On April 29, 1959, the District Court entered the following Order of Dismissal as to the Defendant, Robert A. Riddell:

"IT IS HEREBY ORDERED that the action is dismissed with prejudice as to the defendant, Robert A. Riddell, on the ground that the complaint does not state a claim upon which relief can be granted as to this defendant, and upon the ground that since this appears to be an action for declaratory relief as to the defendant, Robert A. Riddell, with respect to a federal tax matter, the Court has no jurisdiction." (Exh. 11, p. 34).

The Plaintiffs in said action appealed from the District Court's Order of Dismissal to this Court (Exh. 11, p. 36). The United States Court of Appeals for the Ninth Circuit rendered a decision affirming the order of the District Court dismissing the





action as to the Defendant, Robert A. Riddell, District Director of Internal Revenue (283 F 2d 298, 6 AFTR 2d 6185)

The action was then, by agreement of the remaining parties, remanded to the Superior Court (Exh. 12) Thereafter and on November 13, 1961, the Superior Court entered the following judgment:

"The motion of plaintiffs' for judgment on the pleadings came on regularly to be heard the 13th day of October, 1961, ERNEST R. MORTENSON, and associate counsel, by ARN K. YOUNGMAN, appeared as counsel for plaintiffs and ROBERT P. REDDINGUIS appeared as counsel for defendants.

"It appears and the court finds that the complaint states facts entitling plaintiffs to the relief therein prayed for and that the answer fails to state facts sufficient to constitute a defense to said complaint or any portion thereof, WHEREFORE IT IS ORDERED, ADJUDGED, AND DECREED that the Trust Agreements, dated January 1, 1953, executed by the defendants Will Flitcroft and Agnes D. Flitcroft, as trustors, and by the plaintiff Richard H. Miers, as trustee, copies of which are attached to the complaint on file herein marked as Exhibit A and B, be and they hereby are reformed in accordance with the express intent of the trustors and trustee so that the following sentence is added to the first paragraph of each of said Trust Agreements: 'This Trust is irrevocable. '



"IT IS FURTHER ORDERED AND DECREED that said Trust Agreements were irrevocable upon their date of execution, January 1, 1953, and the respective rights and obligations of the parties arising from said Agreements shall be governed accordingly.

"Dated: November 13, 1961        /s/ William E. Fox  
Judge of the Superior Court"

(Exh. 13).

The Commissioner and the Tax Court have refused to recognize that the two trusts created by petitioners on January 1, 1953 were owners of a capital interest in the partnership of Western Hydraulic and for that reason attributed all of the partnership income to these petitioners in the calendar years 1954, 1955 and 1956 (R. 23, 24, 37, 217-247).

About November 1, 1953, Western Hydraulic and Service Company moved into a new plant located at 1510 West 131st Street (R. 226). The building was originally owned 60% by petitioners and 40% by John O. Best, an unrelated party (R. 226). On October 1, 1953, the petitioners created a joint trust for their two children in which Richard H. Miers was also named as trustee (R. 226, 227). At that time petitioners conveyed their 60% interest in the premises at 1510 West 131st Street to said trust (R. 227), and assigned their interest, as lessors, under the lease of the premises to said trust (R. 227). Western Hydraulic and Service Company paid a rent of \$1600.00 per month for the use of the new premises, \$960.00 to





the children's joint trust and \$640.00 to John O. Best (R. 226).

The joint trust agreement of October 1, 1953 provided that the trust should terminate on October 6, 1963. As originally drawn the trust agreement did not expressly provide that the trust was irrevocable (Exh. 20). It was amended on July 30, 1954 to read: "This trust is, by the trustors, hereby expressly made irrevocable." (R. 57, Exh. 21).

The Commissioner of Internal Revenue, in each of the calendar years here involved, held that the rent paid by the partnership transacting business under the fictitious name of Western Hydraulic & Service Company to the Johnel Ann and William R. Flitcroft Trust, was not a deductible business expense of the partnership and accordingly included those amounts in the earnings of the partnership and in the petitioners' distributive shares of the partnership earnings for those years (R. 21, 23, 40). The Tax Court upheld the Commissioner on this point without discussing the question of whether the rent paid was a deductible business expense of the partnership (R. 246).

### SUMMARY OF ARGUMENT

1. The Trusts need not be irrevocable for ten years or more under the decision of Commissioner v. Clark (1953), CA-7, 202 F.2d 94.

2. The Trusts were expressly irrevocable during all the tax years involved in this case.



3. In any event, the Trusts were expressly irrevocable from their inception either by virtue of the provisions of §2250, Civil Code of California, because they were created for the benefit of the grantors, or by virtue of the order of the Superior Court in and for the County of Los Angeles entered November 13, 1961 decreeing "that said Trust Agreements were irrevocable upon their date of execution, January 1, 1953".

4. The co-partnership, Western Hydraulic and Service Company was entitled by §23(a) of the Internal Revenue Code of 1954 to deduct the rent paid on its business premises from its gross income.

## ARGUMENT

### I.

THE TRUSTS CREATED BY THESE PETITIONERS ARE SHOWN BY THE EVIDENCE AND THE FINDINGS OF THE TAX COURT TO IN EVERY INSTANCE HAVE HAD A LIFE IN EXCESS OF TEN YEARS AND TO HAVE, BY THE TERMS OF THE TRUST INSTRUMENTS, BEEN IRREVOCABLE AFTER JULY 30, 1954. EVEN ASSUMING, ARGUENDO, THAT THOSE TRUSTS WERE IRREVOCABLE FOR A PERIOD OF LESS THAN TEN YEARS THEY WERE IMPROPERLY TAXED TO THE GRANTORS FOR THE CALENDAR YEARS 1954, 1955 AND 1956, UNDER THE RULE ANNOUNCED IN THE CASE OF COMMISSIONER vs. CLARK, (1953) CA-7, 202 F.2d 94. THE CLARK CASE HOLDS THAT THE TEN YEAR REQUIREMENT IS UNCONSTITUTIONAL.

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There are two facts found by the Tax Court with respect to which there is no controversy and no room for controversy under the stipulated facts. First: All of the trust agreements expressly



provided at the time they were executed that the trust thereby created should exist for a term of more than ten years. Second On or after July 30, 1954, all of the trust agreements, by virtue of an amendment agreed upon by the trustors and trustees, provided "This Trust is by the trustors, hereby expressly made irrevocable". A third fact found by the Tax Court and supported by the evidence must be accepted as true. It is that the transactions were not shams and there was clearly a transfer of the corpus of the two individual trusts (hereinafter referred to as A and B Trusts) to independent trustees (R. 234).

The Commissioner of Internal Revenue contended that the income of the trusts (A & B) was taxable to the petitioners under §673(a) of the Internal Revenue Code of 1954 if they were irrevocable trusts for a period of less than ten years. The Tax Court concluded, erroneously the petitioners contend for reasons hereinafter asserted, that each trust was revocable until July 30, 1954. Since this review is concerned with no taxable year ending before July 30, 1954, §676(a) of the Internal Revenue Code of 1954 can be disregarded for the reason that there is no contention present that the grantors had power to revest themselves with any portions of the trusts after July 30, 1954.

After it had reached what the petitioners contend was an erroneous conclusion that the trusts were revocable prior to July 30, 1954, the Tax Court still was confronted with the fact that Gaylord v. Commissioner, 153 F.2d 408 (CA-9), 34 AFTR 880, affirming 3 T. C. 281 and Krag v. Commissioner, 8 T. C. 1091,





upon which it relied, did not pass on the question of whether the trusts as amended were still to be treated as revocable trusts for income tax purposes (R. 240). The Tax Court stated "Neither party has called our attention to any case dealing with this question in applying the provisions of the income tax laws." (R. 242) The Tax Court resolved this question by concluding, erroneously the petitioners contend, that the trusts were at no time irrevocable for a period of over ten years and therefore the income was taxable to the grantors under the provisions of §673(a) of the Internal Revenue Code of 1954. The Tax Court also accepted the Commissioner's contention that the provisions of §39.22(a)-21(c) Regs. 118 applied to the taxability of the income of the joint trust (C trust), for the period from July 30, 1954 to December 1, 1954 (R. 247)

The Tax Court's reasoning at this point was confronted by the opinion of the Court of Appeals for the Seventh Circuit in the case of Commissioner v. Clark (1953), 202 F.2d 94, 43 AFTR 259, affirming 17 T. C. 1357, which had been cited by the petitioners. In that case the Circuit Court held the provisions of §29.22(C)-21, Regs. 111, which are substantially the same as those of §39.22(a)-21(c), Regs. 118, to be invalid. The Circuit Court said:

"The Commissioner, in support of his determination of deficiencies for 1946, relies solely upon Treasury Regulation 111, promulgated under the Internal Revenue Code on December 29, 1945, and applicable to taxable years commencing January 1, 1946. The pertinent portion of this regulation is §29.22(c)-21, which provides:



'Income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or the income therefrom which will or may reasonably be expected to take effect in possession or enjoyment -

'(1) within ten years commencing with the date of the transfer \* \* \* '.

"Petitioners attack the regulation upon three grounds: (1) its application to the instant situation would give it a retroactive effect and, in any event, the trusts are not merely for nine years, as asserted by the Commissioner, but are ten-year trusts; (2) the regulation is unreasonable and arbitrary and, therefore, void, and (3) it is unconstitutional inasmuch as it deprives petitioners of their property without due process, that is, without a hearing on the issues existing between the taxpayer and the Commissioner and which arise because of the deficiencies asserted by the Commissioner."

202 F.2d 94, 43 AFTR 259.

The Tax Court sought to distinguish the Clark case by saying that in the present case the regulation involved was in existence at the time of the creation of the joint trust (C Trust), on October 1, 1953. From this the Tax Court concluded that the income of the joint (C Trust) for the period from July 30, 1954 to December 1, 1954, was taxable to the petitioners.

Before proceeding with a discussion of the Clark case the



petitioners pause to point out that the Commissioner has never determined that the income of the joint (C Trust) created on October 1, 1953 was taxable to the grantors at any time. He simply disallowed the partnership, Western Hydraulic, a deduction for the rent it paid that trust. The matter of allowing a deduction for the rent will be discussed in the final chapter of this brief.

The petitioners do urgently contend in this brief that the two trusts (A and B) created on January 1, 1953, were at no time revocable trusts. They also contend that under the rule laid down in the case of Commissioner v. Clark, supra, the income of those trusts would not be taxable to the grantors for the calendar years 1954, 1955 and 1956 even if it were conceded that the trusts were revocable prior to their amendment on July 30, 1954. The Clark case involved interpretation of the provisions of §39.22(c)-21 of Regs. 111. That section of the regulations provided:

"Income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or the income therefrom which will or may be reasonably expected to take effect in possession or enjoyment -

"(1) Within ten years commencing with the date of the transfer \* \* \* ."

This section of Regulations was replaced by §39.22(a)-21(c) (1) of Regs. 118, effective January 1, 1953, which reads:

"Income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus \* \* \*





which will or may reasonably be expected to take effect in possession or enjoyment.

"(1) Within ten years commencing with the date of transfer \* \* \* ."

This regulation was in effect when on August 16, 1954 Congress enacted §673(a) of the Internal Revenue Code of 1954, which provided:

"The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if as of the inception of that portion of the trust, the interest will or may reasonably be expected to take effect in possession or enjoyment within ten years commencing with the date of the transfer of that portion of the trust. "

The report of the House Ways and Means Committee and that of the Senate Finance Committee, found at pages 4553 and 5007 of Vol. 3, 1954 United States Code, Congressional and Administrative News, with respect to §673(a) of the Internal Revenue Code of 1954 both state:

"This section contains the rules applicable to the short term trust containing the provision for a reversion to the grantor. The section enacts in statutory form provisions in lieu of those contained in §39.22(a)-21(c)



The current regulation, §1 673(a), first filed on December 19, 1956, as Treasury Decision 6217, contains substantially the same provisions.

It will assist in the discussion of the Clark case to compare the Flitcroft trusts, A, B and C with the Clark trust in respect to the time intervals between the time the trust instruments were amended and the date the agreements expired.

<u>A Trust</u>	<u>B Trust</u>	<u>C Trust</u>	<u>Clark Trust</u>
8 years	8 years	9 years	9 years
5 months	5 months	3 months	

The Flitcroft trusts, A and B, were to operate under written trust instruments making them expressly irrevocable for eight years and five months and the C Trust for nine years and three months after the amendments of July 30, 1954. The Clark trust was to operate for nine years after its trust agreement was amended to extend its already irrevocable term from five years to ten years. All four of the trusts were expressly irrevocable trusts during the years in which the disputed deficiencies arose. It was clear that the grantors of the Flitcroft trusts did not have a reversionary interest that could be reasonably expected to take effect in possession or enjoyment within ten years commencing with the dates of the respective transfers to the trusts at any time after July 30, 1954, within the meaning of §39.22(a)-21(c)(1) of Regulation 118. It is significant that the Commissioner did not determine that the



income of the Flitcroft C Trust, was taxable to the grantors.

In its opinion the Tax Court held that in the instant case the regulation involved was in existence at the time of the creation of the joint trust (C Trust). But the income of that trust was not attacked by the Commissioner. However, the regulation §39.22(a)-21(c)(1) of Regulations became effective on January 1, 1952, and was also in existence on January 1, 1953 when the individual trusts, A and B, which are under attack, were created. Section 673(a) of the Internal Revenue Code of 1954 had not been enacted when any of the trusts were created, nor was it in effect when the trust instruments were amended on July 30, 1954. See also §7851(a)(2)(B) of the Internal Revenue Code of 1954, which preserves rights in existence when that Code was enacted. But the fault of retroactivity was not the only one found with the Clark trust by the Tax Court and the Court of Appeals for the Seventh Circuit in Commissioner v. Clark, supra.

The Court of Appeals also decided that the regulation was invalid because it violated the provisions of the Fifth Amendment of the Constitution of the United States when it created a conclusive presumption that the grantor of a trust was the owner of the corpus and income derived from the corpus for the sole reason that the trust had a duration of less than ten years. The Seventh Circuit also pointed out that even Congress would be without power to create such a conclusive presumption. Since then Congress has made an attempt to do so by the enactment of §673(a) of the Internal Revenue Code of 1954 upon which the Commissioner and Tax Court





here rely. No case contrary to that of Commissioner v. Clark, supra, has been found. It is submitted that both §39.22(a)-21(c), Regs. 118 and §673(a), Internal Revenue Code of 1954 were and are unconstitutional and void.

The Court of Appeals in the Clark case also held §29.22(c)-21 of Regs. 111 to be void because it was arbitrary and unreasonable. It is submitted that §39.22(a)-21(c) contained exactly the same fault and was also void.

The Tax Court found it to be a fact that the corpus of the Flitcroft A and B trusts was transferred to independent trustees who controlled the corpus of those trusts and that the transactions were not shams (R. 234). This finding leaves no room for the application of the case of Clifford v. United States (1940), 309 U.S. 331.

The petitioners contend in the following chapter of this brief that because of the limitations placed upon the operation of §2280 of the Civil Code of California by §2250 of that Code neither of the Flitcroft trusts, A and B, were ever as a matter of fact or law, revocable. Aside from that contention it is submitted that it follows from the facts found by the Tax Court that upon the authority of Commissioner v. Clark, supra, no part of the income of trusts A and B was taxable to the grantors in the calendar years 1954, 1955 and 1956 for the reason that the trust instruments themselves, at all times after July 30, 1954, expressly provided that the trusts were irrevocable.



## II.

THE TRUSTS CREATED FOR WILLIAM R FLITCROFT AND JOHNE L ANN FLITCROFT BY THEIR PARENTS, THE APPELLANTS HEREIN, ON JANUARY 1, 1953, WERE PARTLY FOR THE BENEFIT OF THE TRUSTORS AND THEREFORE NOT REVOCABLE UNDER THE PROVISIONS OF §2280 OF THE CIVIL CODE OF CALIFORNIA BECAUSE OF THE LIMITING PROVISIONS OF §2250 OF THAT CODE

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This is a family partnership case in which the Tax Court has, upon abundant evidence, found as a fact that half of the original partnership's assets were transferred to a trustee for two trusts that the petitioners created for their children on January 1, 1953; that the trusts then entered a new partnership agreement with the trustors to conduct the business of Western Hydraulic and Service Company, that these transactions were not shams; that the trustees were unrelated and independent, that capital was a material income-producing factor in the partnership, Western Hydraulic, that the grantors received none of the trust income and that the trustee performed services for the partnership. These trusts will hereinafter be called A and B trusts in this brief. The central question presented to this Court on Review is that of whether the two trusts created for petitioners' children were each the owner of a one-fourth capital interest in the family partnership. If those trusts were the owners of a half interest in the partnership during the taxable year involved, the law is well established that half of the partnership income must be attributed and taxed to them and not to these petitioners. Poggetto v. United States (1962), CA-9,



Section 704(c)(1) of the Internal Revenue Code of 1954 provides: In §7 of the Senate Finance Committee Report on H. R. 4473 Proposed Revenue Act of 1951, dealing with family partnerships, and in the Ways and Means Committee Report on the same subject the following pertinent comment is found:

"2/ In Sec. 7 of the Senate Finance Committee Report on H. F. 4473, Proposed Revenue Act of 1951, dealing with family partnerships, and in the Ways and Means Committee Report on the same subject, the present confused state of the law is thus summarized:

" 'Section 339 of your committee's bill is intended to harmonize the rules governing interests in the so-called family partnership with those generally applicable to other forms of property or business. Two principles governing attribution of income have long been accepted as basic: (1) Income from property is attributable to the owner of the property; (2) income from personal service is attributable to the person rendering the services. There is no reason for applying different principles to partnership income. If an individual makes a bona fide gift of real estate, or of a share of corporate stock, the rent or dividend income is taxable to the donee. Your committee's amendment makes it clear that, however the owner of a partnership interest may have acquired such interest, the income is taxable to the owner, if he is the real owner.





If the ownership is real, it does not matter what motivated the transfer to him or whether the business benefited from the entrance of the new partner.

" 'Although there is no basis under existing statutes for any different treatment of partnership interests, some decisions in this field have ignored the principle that income from property is to be taxed to the owner of the property. ' "

The Commissioner attacked the partnership on the ground that trusts A and B should not be recognized for income tax purposes. His arguments before the Tax Court disclose that the sole basis for refusing to recognize trusts A and B as partners in Western Hydraulic and Service was that for the period of time elapsing between the creation of the trusts on January 1, 1953 and July 30, 1954 (one year and seven months) the trust instruments themselves did not expressly provide that the trusts were irrevocable. It has been pointed out in the previous chapter of this brief that under the holding of the case of Commissioner v. Clark (1953), 202 F.2d 94, 43 AFTR 259, trusts A and B were valid and entitled to recognition even upon the Tax Court's finding that the trust agreements were by their express terms irrevocable only after their amendment on July 30, 1954. However, the petitioners submit that the trusts were, in fact, irrevocable trusts at all times, both before and after their amendment under the applicable law of California.



The Tax Court's opinion cites the provisions of §2280 of the Civil Code of California to support its conclusion that the A and B trusts were revocable and the petitioners, rather than the trusts, the owners of all of the partnership capital, within the intent of §676(a) and §673(a) of the Internal Revenue Code of 1954 during the calendar years 1954, 1955 and 1956. In so doing it is submitted the Tax Court committed the error of refusing to follow the law of California as found in §2250 of the Civil Code of California and the judgment of the Superior Court of the State of California entered in the case of Botsford, et al. v. Flitcroft on November 13, 1961. The Tax Court cited the decision of this Court in Gaylord v. Commissioner (1946), 153 F.2d 408, 34 AFTR 880, affirming 3 T. C. 281 and Erik Krag (1947), 8 T. C. 1091 in support of its action. The petitioners do not here quarrel with those decisions. They do urge that they do not apply.

In the Gaylord and Krag cases, supra, title to the trust corpus was also vested in the trustee, as §2250 of the Civil Code of California requires it to be as a condition precedent to the application of §2280 contained in the same chapter of that Code. In the A and B trusts title to the trust property was also transferred to the trustee.

In the Gaylord and Krag cases the trustor and the trustee were, in each case, the same person. In the pending cases Richard H. Miers and later Frederick L. Botsford were found by the Tax Court to be independent and unrelated trustees. In the Gaylord and Krag cases the grantors received no benefit from the execution of



the trust agreements. In the Flitcroft cases the trustors expected to and did obtain and retain the valued services of Richard H. Miers in the partnership business of Western Hydraulic and Service Company. That was a business benefit to the trustors. Pike v. United States (1956), CA-9, 231 F.2d 515, 49 AFTR 515, 519. The Gaylord and Krag trusts were passive trusts holding nothing but shares of corporate stock and not involved in any partnership activities. The Flitcroft trusts held half of the capital and through their trustee actively participated as general partners in the very active partnership business of Western Hydraulic and Service Company. The Flitcroft trust instruments did provide in express terms that the trusts were irrevocable during the years here in question. The Gaylord and Krag trust instruments did not so provide and gave no room for the rule of Commissioner v. Clark, supra, to operate.

It is submitted that the trusts are not the same kind of trusts as those involved in the Gaylord and Krag cases, upon which the Tax Court predicates its opinion. Nor are they trusts to which the provisions of §2280 of the Civil Code of California apply for the reason that the grantors are shown to have received a benefit from the creator of the trusts. In the Gaylord and Krag trusts no benefit to the trustors followed from their creation and in that respect they met the second requirement of §2250 of the Civil Code of California and were accordingly to be considered revocable because of §2280 contained in the same chapter of that Code. The A and B trusts were not passive trusts; they participated through the trustee,





as general partners in the grantors' very active business of Western Hydraulic. That was a consideration or benefit flowing to the trust grantors. Further, there is a statutory presumption that a written contract and the A and B Trust Agreements were in writing, is supported by a good and sufficient consideration. Section 1614, California Civil Code; Blonder v. Gentile (1957), 149 Cal. App. 2d 869, 874, 309 P. 2d 147. The second requirement of §2250 was not met.

It is submitted that §2280 of the Civil Code of California did not apply to the A and B Trusts for the reason that §2250 of that Code limits the provisions of §2280 found in the same chapter II of the California Code to trusts in which the trustor derives no benefit.

The California courts have construed the word "voluntary" as used in §2280 of the Civil Code of California not to mean a "voluntary" trust in the broad sense found in §2216, but in the restricted sense of a trust created freely and without a valuable consideration or legal obligation. Touli v. Santa Cruz County Title Co. (1937), 20 Cal. App. 2d 495, 497; 67 P. 2d 404. In that case the California Court of Appeal used the following apt language (20 Cal. App. 2d 499):

"The judgment must be reversed for these reasons:

"(1) Section 2280 of the Civil Code, which permits the revocation of a trust 'unless expressly made irrevocable by the instrument' relates only to a 'voluntary' trust created without a valuable consideration passing to the trustor, and



does not apply to a deed of trust giving as security for the payment of an obligation. This follows from a consideration of the legislation as a whole. The original section was based on Field's Draft of the New York Civil Code, section 1209, and was enacted in 1872 when a deed of trust such as that involved here was 'both in legal effect and in theory' deemed to be a mortgage with a power of sale and differed 'not at all from a mortgage with a power of sale'. (Bank of Italy Nat. T. & S. Assn. v. Bentley, 217 Cal. 644, 654 [20 Pac.(2d) 940].) The expression 'voluntary' trust was first used in the section when it was redrafted by the amendment of 1931. At that time the distinction between an ordinary express trust and the common deed of trust given as security for an obligation was clearly defined in the California decisions and was well known to the law-makers. A voluntary trust was defined in section 2216 of the Civil Code as 'an obligation arising out of a personal confidence reposed in, and voluntarily accepted by, one for the benefit of another'. But this section was also enacted in 1872 and was based upon Field's Draft of the New York Civil Code, and hence the legislature could not have had in mind a trust identical to 'a mortgage with a power of sale'. Webster's New International Dictionary under the heading 'voluntary-law' gives this definition: 'Acting, or done, of one's own free will without valuable consideration, acting, or done, without any present legal



obligation to do the thing done ' It was in the latter sense that the word 'voluntary' was used in the amended section, otherwise it would not have been coupled with the word 'revocable' without reservation. The word 'revoke' literally means to 'call back'. It is synonymous with 'rescind', to 'recall' and 'to cancel'. It does not mean 'repudiation'. A deed of trust given to secure an obligation is a contract, the right to rescind which is granted and limited by express provisions of the Civil Code to which we will hereafter refer. It must follow, therefore, that when section 2280 was drafted to permit the revocation of a 'voluntary' trust, that expression was not used in the broad sense found in section 2216, but in the restricted sense of a trust created freely and without a valuable consideration or legal obligation. Otherwise the legislature would have restricted the revocation, or rescission, to the general equitable safeguards placed upon mortgages and contracts in general.

"This view is fortified by a consideration of the structure of the code in which these sections appear. Section 2280 is a part of article V of chapter 2 of the article on trusts. Section 2250, which is in article I of that chapter reads: 'The provisions of this chapter apply only to express trusts, created for the benefit of another than the trustor, and in which the title to the trust property is vested in the trustee; not including, however,





those of executors, administrators, and guardians, as such.' A deed of trust such as we have here is created for the benefit of the trustor and the named beneficiary. (Humboldt Sav. Bank v. McCleverty, 161 Cal. 285, 290 [119 Pac. 82]; Ainsa v. Mercantile Trust Co., 174 Cal. 504, 510 [163 Pac. 898]; Atkinson v. Foote, 44 Cal. App. 149, 156 [186 Pac. 831]; Kellum v. San Mateo County Title Co., 127 Cal. App. 276, 279 [15 Pac (2d) 876]; 25 Cal. Jur., pp. 11, 12, 42.) The author in California Jurisprudence at page 11 correctly concludes that the ordinary deed of trust 'is not, therefore, governed by the chapter of the Civil Code beginning with section 2250, as that refers to those trusts which are entirely for the benefit of third persons, wherein the title wholly passes to the trustee, there being nothing to be done for the benefit of the trustor -- nothing left in or to be returned to him.' Hence, a deed of trust given as security for an obligation is not a trust 'created for the benefit of another than the trustor', but is one created for the benefit of the trustor as well as for the benefit of the named beneficiary."

"The deed of trust is a contract wherein mutual obligations are imposed upon the trustor, the trustee, and the beneficiary. If §2280 could be applied on any theory to such a deed of trust, the revocation permitted by that section is nothing more than a rescission of this contract. As such it is controlled by the provisions of §1689 et seq.



of the Civil Code and particularly by the provisions of §1691, sub-division 2, declaring that the actor must 'restore to the other party everything of value which he has received from him under the contract'."

It is true, as the Tax Court states in its opinion (R. 238), that the Touli case, supra, was discussing an ordinary deed of trust given as security for a loan. The Tax Court then immediately concluded as a matter of law that the A and B trusts here involved were voluntary express trusts for the benefit of another than the grantor because they did not also involve a trust deed or loan of money. It is submitted that it does not follow at all that merely because the A and B trusts were not also trust deeds or security for a loan they were voluntary express trusts for the benefit of another than the grantor. The Tax Court says "the trusts themselves state that they are without consideration". The record discloses that the trust agreements state there was no consideration on the trustor's part. But the Tax Court had in the opening paragraph of its opinion correctly concluded that, as a matter of law, the partnership agreement and trust agreements, all dated January 1, 1953, were part of the same transaction and are required to be read together (R. 234). This first conclusion is strongly supported by the evidence in the record and by the facts which the Tax Court has found. There lay the benefit to the grantors. They were obtaining and retaining the valuable services of an employee in their already existing business, Western Hydraulic &



Service Company, by substantially the same procedure that was followed in the case of Pike v. United States, supra. A written instrument is presumptive evidence of a consideration. Section 1614, Civil Code of California. This presumption is disputable but the burden of showing want of consideration lies with the parties seeking to invalidate or avoid the instrument. Blonder v. Gentile, supra.

In further support of its conclusion that the A and B trusts were voluntary express trusts for the benefit of another than the grantor the Tax Court said:

"The evidence fails to show any benefit to petitioners of Miers' work for Western Hydraulic which was different after the creation of the trusts from before. Both before and after the creation of the trusts Miers did work of an accounting nature for Western Hydraulic at a fee of \$60 per day. The record does not show any other activities engaged in by Miers in connection with the partnership except his consultation on partnership matters with petitioners. There is no evidence to show that the consultations were of any benefit to petitioners or that they were not solely in the interests of the trusts." (R. 239).

These are surprising conclusions and appear to have been made by the Tax Court either because it overlooked the facts found by it or else for the sole purpose of trying to force the present case to fit the mold in which the cases of Gaylord v. Commissioner (1946), CCA-9, 153 F.2d 408, 34 AFTR 880, affirming 3 T. C. 281 and





Erik Krag v. Commissioner (1947), 8 T C 1091 were cast. The same judge, in the same cases and earlier in the very same opinion filed by the Tax Court in the Flitcroft cases had found as facts that:

"During the years 1953 through 1956 Miers spent most of his time in connection with the business of Western Hydraulic. He took charge of production control, accounting, contract negotiations, renegotiation of government contracts, and cost records. He also handled labor relations for the partnership and served as its controller, as well as working with the sales and engineering departments on the submission of bids for contracts. He hired office personnel and dealt directly with customers of Western Hydraulic."

(R. 225, 226).

The evidence in the record and the facts found therefrom by the Tax Court of benefits to petitioners from Miers' services are impressive and do not support the conclusion that no benefit to the petitioners from Miers' work was shown.

The Tax Court has found as a fact that prior to the formation of the A and B trusts in controversy and the related partnership between the petitioners and those trusts on January 1, 1953, Will Flitcroft worked long hours, six and sometimes seven days a week (R. 220). Will Flitcroft testified that "it was a question of getting someone in there to do a good job with me or break my health down (R. 77). The general nature of the partnership agreement was that Mr. Miers was to devote all of the time he could devote to



the business which he probably did about ninety-nine per cent of his time and he had a few other accounts that he let go and devoted the bulk of his time to Western Hydraulic and Service Company and helping me to operate a more efficient and better business that could progress in the future (R. 79, 80). He took a terrific load off my back." (R. 20). It is submitted that the grantors of the A and B trusts gained a benefit for themselves when, by the execution of the trust and partnership agreements, they obtained and retained the sorely needed services and ability of Richard H. Miers in their partnership, Western Hydraulic. The benefit to the trustors may well have been much larger than the loan of money obtained by the trustors under the trust deed in the Touli case, supra. In either event §2280 of the Civil Code of California would not apply to make the trusts irrevocable for the sole reason that the trust agreements did not expressly state that the trusts were irrevocable. The trusts were irrevocable because made for the benefit of the grantors. Section 2280, Civil Code of California; Touli v. Santa Cruz County Title Company, supra. They could only be terminated by rescission -- never by revocation. Touli, supra.

Richard H. Miers, the trustee, testified as follows:

"So I volunteered my services and Mr. Flitcroft took me up on it. And we devised these trusts, set up the partnership, primarily for expansion purposes so that we could expand the operation. \* \* \* Shortly after they settled the situation in Korea the volume decreased somewhat, but then it turned back up and doubled " (R. 88).



It is submitted that the doubling of the business of the partnership, Western Hydraulic, was also a benefit or consideration flowing to the grantors of the A and B trusts which, by virtue of the provisions of §2250 of the Civil Code of California, prevented those trusts from being revocable under the provisions of §2280 of the Code. A voluntary trust created without a benefit or consideration to the grantor may be revoked by the grantor. But where the grantor does receive a benefit or consideration from the creation of the voluntary trust he is not at liberty to revoke it. Section 2250 California Civil Code. In the latter circumstances he might, where some of the conditions enumerated in §1689, et seq. of the California Civil Code exist, rescind the trust agreement. There is a vast legal difference between revoking and rescinding a trust agreement. That is to say the grantors had received a consideration, a promise of the services of Miers in the business of Western Hydraulic, and could therefore not revoke the trust. The trusts could only be terminated in less than ten years by a rescission brought about under §1691(2) of the California Civil Code. Touli, supra, is submitted that the Tax Court was confronted with the possibility that the trusts might be rescinded for the causes set forth in §1689 of the Civil Code of California but not the grantor's power to revoke them under §2280 of that Code. That possibility of rescission is not the same thing as the power to revoke, of which §676(a) of the Internal Revenue Code of 1954 treats. The contingent possibility of rescission was not a reversionary interest held by the grantors of the A and B trusts within the meaning of §673(a) of





the Internal Revenue Code of 1954 and §39.22(a)-21(c), Regs. 110.

The Tax Court appears to have been of the impression that all the compensation Miers, the trustee, received for his activities on behalf of Western Hydraulic was his accountant's fee of \$60 per day (R. 239). This is not true. Article VI of the respective trust instruments provided that he should receive 4% of the first \$25,000 of trust income, 37% on the next \$15,000 and 2% on the balance of such income each year from each trust (Exs. 5, 6, 20). Computation made from the net income reported by A and B trusts as shown by the findings of the Tax Court discloses that the trustee fees would amount to approximately \$1,593.17, \$1,134.52 and \$1,386.75 for the calendar years 1954, 1955 and 1956, respectively (R. 218). The trust income consisted principally of their distributive share of the partnership income of Western Hydraulic (Pet Exs. 25, 26, 27, 28, 37, 38, 39, 40, 41, 42, 43, 44). Following December 1, 1954, Frederick L. Botsford was a co-trustee and shared the trustee's fees (R. 211). Miers was not an employee of the partnership but he did serve the interests of the grantors of A and B trusts in the conduct of the business of Western Hydraulic. His trustee's fee was a form of incentive pay for duties, other than those of an accounting nature, performed in the partnership venture and was indirectly received from Western Hydraulic.

The Tax Court has concluded that as a matter of law the judgment of the California Court of November 13, 1961 declaring the A and B trusts of January 1, 1954, to have been irrevocable upon their date of execution, January 1, 1953, was collusive. It



next concluded the trusts were revocable until their amendment on July 30, 1954. This conclusion begs the question at issue. Petitioners contend that on the authority of §2250 of the California Civil Code the trusts were at no time revocable because the grantors received a benefit by their creation. They also contend, upon the authority of Commissioner v. Clark, supra, that since the trusts were, by amendment, made expressly irrevocable during the calendar years 1954, 1955 and 1956 they must be recognized as owners of a partnership interest in Western Hydraulic during those years. The Tax Court ultimately concluded that the trusts were at no time irrevocable for a period of over ten years and therefore the income from them was taxable to the grantors (R. 237). The petitioners take the position that the amendments of the trust instruments on July 30, 1954, has nothing to do with the question of whether the trusts were irrevocable at their inception. Further along in its opinion the Tax Court said: "Petitioners conclude from this that since the trusts here involved were amended or reformed to make them expressly irrevocable on July 30, 1954 and have at all times been for terms exceeding ten years that they were irrevocable trusts for terms of over ten years during the calendar years 1954, 1955 and 1956" (R. 245). At this point the Tax Court simply failed to grasp the arguments presented to it. Petitioners' contention was and is, first: The trusts were irrevocable from their inception on January 1, 1953, because a benefit accrued to the grantors. Second, the judgment of the Superior Court of California of November 13, 1961, reformed the



trust instruments as originally drawn on January 1, 1953 (not the trust instruments as they read after their amendment on July 30, 1954), to express the original intent of the parties to the trust instruments that they provide "This trust is irrevocable". It is not contended the judgment operated to make an irrevocable trust out of one that was originally revocable by the grantor. It is contended the grantors never possessed the power to revoke because of the limitations §2250 of the Civil Code of California places upon the operation of §2280. The judgment of reformation merely reformed the contract to read as the parties always intended it to read. It incidentally expressed the intention of the California legislature as manifested in the provisions of §2250 of the Civil Code of that State, that trusts in which the grantors receive a benefit are at all times irrevocable. It is the rule under the California law that reformation of an instrument relates back to the date of the instrument and binds everyone but interim purchasers for value. Section 3399, California Civil Code; Baines v. Zuieback (1948), 84 Cal. App. 2d 483, 191 P. 2d 67. The California law is to be followed, Erie Railroad Co. v. Tompkins (1938), 304 U. S. 64, reversing CA-2, 90 F. 2d 603.

There is a distinction under the California law between an action for Declaratory Judgment and one to reform a contract. The object of the former is to resolve a controversy and of the latter to correct a mistake of the parties (or the scrivener) to a written instrument. In the former it is a prerequisite to maintenance of the action that there be an actual controversy relating to the legal





rights and duties of the respective parties. Section 1060, California Code of Civil Procedure. In the latter it is not necessary that there be an actual controversy. A conceded mistake will suffice. Section 3399, California Civil Code. The language used by the Tax Court in the case of Erik Krag (1947), 8 T. C. 1091, indicates that it may not have been fully aware of the distinction between an action for declaratory relief and one for the reformation of a contract under the California statutes:

The Tax Court there said:

"It is also true, as contended by petitioners, that the cited cases hold that decisions of state courts determining property rights are binding upon Federal courts. However, such rule applies only to a decision entered in a proceeding presenting a real controversy for determination. The decision must be on issues 'regularly submitted and not in any sense a consent decree'.

Freuler v. Helvering, 291 U. S. 35, see also Francis Doll, 2 T. C. 276, affd., 149 F. 2d 239, certiorari denied, 326 U. S. 725; Tatem Wofford, 5 T. C. 1152, 1161-1163; Leslie H. Green, 7 T. C. 263, 274. In the suit herein involved there was no real controversy."

It justified this language with a citation from Freuler v. Helvering, 291 U. S. 35 and Sinopoulo v. Jones, supra. A reading of the opinion in Freuler does not disclose that the Supreme Court so held. The Tax Court appears to have quoted a contention that the Commissioner made and the Supreme Court rejected as being a



holding of the Court. However, the Supreme Court did make the following applicable statements in its opinion:

"Moreover, the decision of that court, until reversed or overruled, establishes the law of California respecting distribution of the trust estate. It is nonetheless a declaration of the law of the state because not based on a statute, or earlier decision. The rights of the beneficiaries are property rights and the court has adjudicated them." (Emphasis supplied).

" \* \* \* We cannot seize on the form of the settlement made between the parties either to impugn the good faith and judicial character of the state court's decree, or to ignore the decree and its conclusiveness as to what was in fact and in law income distributable to the beneficiaries under the trust. " 13 AFTR 838.

The prayer of the Complaint in the Superior Court asked both for a reformation of the trust instruments and a declaratory judgment adjudicating the respective rights of trustors and trustees under the trust instruments. The Superior Court gave judgment accordingly.

There is no statutory requirement in California that an actual controversy between the parties exist in an action for the reformation of a written instrument. Section 3399, California Civil Code. Section 1060 of the California Code of Civil Procedure does, on the other hand, provide that there must be an actual



controversy relating to the legal rights and duties of the respective parties before an action for Declaratory Relief may be maintained in the Superior Court. Section 1061 of that Code provides that "The Court may refuse to exercise the power granted by the chapter in any case where its declaration or determination is not necessary or proper at the time under all the circumstances." It is submitted that the Tax Court "impugns the good faith and judicial character of the State Court's decree" when it holds that the judgment for declaratory relief of November 13, 1961, was collusive.

In the first place it must be assumed that the Superior Court had determined in advance that an actual controversy existed else it would have exercised the power to refuse to entertain the action for declaratory relief given it by §1061 of the Code. In the second place the record before the Tax Court has led it to conclude that the A and B trusts were revocable prior to July 30, 1954. In the event the Tax Court is correct, the trustee, as a partner in Western Hydraulic, had already reported and paid more than \$8,000 in Federal income taxes for the calendar years 1953 for each of said trusts which the trust did not owe (Pet. Exhs. 37, 41). Each trust was assessed with a deficiency in tax for that year of \$975.79 (Pet. Exhs. 37, 41). Substantial sums had been reported and paid as income taxes by each trust for the years 1954, 1955 and 1956. If these payments were erroneous, because the trusts were revocable, the trustee needed to know that as it would be a fiduciary's duty to file a timely claim for the refund of any taxes he had erroneously paid for the trust. If, on the other hand, he filed a false claim he





would be subject to severe penalties. If the trusts were, in fact, irrevocable and the trustee failed to report their income for taxation he might be subject to criminal prosecution. The Federal taxes paid would have an effect on the California income taxes of the trusts. The taxes paid by the trusts might also have an effect upon the compensation to which the trustees would be entitled. These were reasons for seeking a declaratory judgment independent of its effect upon the Federal tax question presently in controversy between the grantors and the Government. There were no such independent reasons for seeking a declaratory judgment present in the Gaylord and Krag cases, supra.

It is submitted that the Tax Court erred in failing to find and conclude that the A and B trusts were ten year irrevocable trusts from the date of their creation on January 1, 1953 by virtue of the decision of the Superior Court of California so holding as well as the provisions of §2250 of the Civil Code of California.

### III.

THE RENT PAID BY WESTERN HYDRAULIC AND SERVICE COMPANY TO THE JOHNEL ANN AND WILLIAM R. FLITCROFT TRUST ("C" TRUST) FOR THE USE AND POSSESSION OF ITS FACTORY PREMISES IS AN ALLOWABLE DEDUCTION FROM ITS GROSS INCOME FOR THE CALENDAR YEARS 1954, 1955 AND 1956 UNDER THE PROVISIONS OF §162(a)(3) OF THE INTERNAL REVENUE CODE OF 1954.

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The Johnel A. Flitcroft and William R. Flitcroft Trust ("C" Trust) was the legal owner, and it held an assignment of



petitioners' interest as lessors of the property located at 1510 West 135th Street in Gardena, California (Pet Exhs. 23, 36). Western Hydraulic and Service Company's manufacturing plant occupied the property under an agreement of lease dated September 15, 1953, in which Will Flitcroft, Agnes D. Flitcroft, John O. Best and Blanche Adams Best were the lessors. The rental provided for was \$192,000.00 or \$1,600.00 per month for a ten-year period following October 1, 1953 (Pet. Exh. 24). "C" Trust received a rent of \$960.00 a month and John O. Best and wife received a rent of \$640.00 a month from Western Hydraulic and Service Company (Tr. 106, 47).

Western Hydraulic and Service Company claimed and was allowed or disallowed the following rental deductions on its partnership returns of income (form 1065):

<u>Year</u>	<u>Rental Claimed</u>	<u>Disallowed</u>	<u>Allowed</u>
1953	\$ 3,090.00	\$ 2,690.00	\$ 400.00
1954	22,392.83	11,520.00	10,872.83
1955	19,200.00	11,520.00	7,680.00
1956	19,200.00	11,520.00	7,680.00

(Exhs. 25-E, 26-F, 27-G, 28-H -- Deficiency Notice).

The rental paid by Western Hydraulic and Service Company was computed on the basis of eight cents a square foot per month. The figure was arrived at after a survey of the area was made and eight cents a square foot was found equitable (Tr. 105).

Section 162(a)(3) of the 1954 Internal Revenue Code provides



in so many words:

"There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including --

"(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity \* \* \* "

In the pending proceedings the respondent has held in his deficiency notices "that the rent paid by the partnership transacting business under the fictitious firm name of Western Hydraulic and Service Company to the Johnel Ann and William R. Flitcroft trust, \* \* \* is not a deductible business expense of the partnership". His action simply ignores the provisions of the Internal Revenue Codes that a deduction shall be allowed for rentals paid for the use of property used in a trade or business. There is not a scintilla of evidence in the record that the leased property was not used in the business of the partnership or that a monthly rental of eight cents per square foot for the space used was not reasonable. There is uncontradicted evidence to the contrary. In fact, the respondent himself has allowed the portion of the rent (40% or 3.2 cents per square foot) which the partnership paid to the co-owners of the property, John O. Best and Blanche Adams Best. How he arrived





at a conclusion that all of the rent paid to two of the co-owners of the leased premises and none of the rent paid to the other one was a deductible business expense of the partnership is explained by neither the deficiency notices nor respondent's answers to the petitions herein.

The Tax Court refused to sustain the Commissioner's disallowance of rentals paid to a family corporation where that rent was fair and reasonable. Neel v. Commissioner (1954), 22 T.C. 1083; Rays Clothes, Inc. v. Commissioner (1954), 22 T.C. 1332. The deduction was allowed where the rent was paid to trusts for children of the lessee's controlling stockholders. Southern Ford Tractor Co. v. Commissioner (1958), 22 T.C. 822; Consolidated Apparel Co. v. Commissioner (1953), CA-7, 207 F.2d 580, 44 AFTR 515, reversing 17 T.C. 570.

It is submitted that the respondent's action in denying Western Hydraulic and Service Company a deduction for rent paid the Johnel Ann Flitcroft and William R. Flitcroft Trust in the taxable years 1954, 1955 and 1956 was arbitrary, unwarranted and contrary to the specific provisions of §162(a)(3) of the Internal Revenue Code of 1954.



CONCLUSION

It is respectfully submitted that the decisions of the Tax Court here on review should be reversed.

Dated: June 4, 1963.

Respectfully submitted,

ERNEST R. MORTENSON

EUGENE HARPOLE

By /s/ Eugene Harpole

EUGENE HARPOLE

Attorneys for Appellants









A PPENDIX "A"

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CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that in my opinion this brief is in full compliance with those rules.

/s/ Eugene Harpole

EUGENE HARPOLE





No. 18628

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**In the United States Court of Appeals  
for the Ninth Circuit**

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WILL FLITCROFT AND AGNES D. FLITCROFT, PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

---

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX  
COURT OF THE UNITED STATES

---

**BRIEF FOR THE RESPONDENT**

---

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**FILED**

AUG 24 1963

FRANK H. SCHMID, CLERK



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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 18628

**WILL FLITCROFT AND AGNES D. FLITCROFT, PETITIONERS**

*v.*

**COMMISSIONER OF INTERNAL REVENUE, RESPONDENT**

---

*ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX  
COURT OF THE UNITED STATES*

---

**BRIEF FOR THE RESPONDENT**

---

**OPINION BELOW**

The findings of fact and opinion of the Tax Court (R. 217-247) are reported at 39 T.C. 52.

**JURISDICTION**

This petition for review (R. 262-266) involves federal income taxes for the taxable years 1954, 1955 and 1956. On March 11, 1959, the Commissioner of Internal Revenue mailed to taxpayers a notice of deficiency for the taxable years 1953 and 1954 in the sum of \$76,240.81. (R. 16-24.) Within ninety days thereafter and on May 4, 1959, the taxpayers filed a petition with the Tax Court for a redetermination of that deficiency under the provisions of Section 6213(a) of the Internal Revenue Code of 1954. (R. 9-15.) On

August 5, 1960, the Commissioner of Internal Revenue mailed to taxpayers a notice of deficiency for the taxable years 1955 and 1956 in the sum of \$56,713.74. (R. 36-41.) Within ninety days thereafter and on September 6, 1960, taxpayers filed a petition with the Tax Court for redetermination of that deficiency under the provisions of Section 6213(a) of the Internal Revenue Code of 1954. (R. 31-35.) At the Tax Court hearing the cases were consolidated for trial, briefing, and opinion. (R. 70.) The decision of the Tax Court for the years 1953 and 1954 was entered on December 18, 1962. (R. 258.) The decision of the Tax Court for the years 1955 and 1956 was entered on December 20, 1962. (R. 260.) The case is brought to this Court by a petition for review filed March 11, 1963. (R. 262-266.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

#### QUESTION PRESENTED

Was the income of three short-term trusts set up by taxpayers in behalf of their minor children includible in taxpayers' gross income under the provisions of Section 673(a) of the Internal Revenue Code of 1954?

#### STATUTES AND REGULATIONS INVOLVED

The applicable statutes and Regulations may be found in the Appendix, *infra*.

#### STATEMENT

The facts as found by the Tax Court (R. 218-233) may be summarized as follows:

Taxpayers, Will and Agnes Fliteroft, reside in Los Angeles County, California. They first became associated with a partnership known as Western Hydraulic & Service Company (hereinafter referred to as Western Hydraulic) on November 1, 1945, when they and two other persons executed a partnership agreement under which each became a partner with a 25 percent interest in the partnership. The partnership was formed for the manufacture and assembly of hydraulic parts, assemblies, and fittings, general machine shop work, manufacturing work, and the servicing of hydraulic parts, assemblies, and fittings. The duties of Will Fliteroft in the partnership consisted of managing the plant facilities and supervising production, and the duties of one of the other partners consisted of contacting customers and selling partnership products. The duties of Agnes D. Fliteroft under this agreement were not specified. (R. 218-219.)

On April 1, 1946, the partnership between taxpayers and their two partners terminated and on the same date taxpayers purchased the partnership interest of the other two partners and formed a new partnership in which each owned a 50 percent interest. During the years 1946 through 1952 taxpayers, as partners, operated the business of Western Hydraulic at a plant facility located at 70th and Central Avenue, Los Angeles, California, and subsequent to 1952 and until about November 12, 1953, the business of Western Hydraulic was operated at a plant facility located on West 136th Street in Gardena, California. The property at 70th and Central Avenue was owned



personally by Will Flitcroft and the partnership was permitted to use this property without a lease and without payment of rent therefor. Will Flitcroft managed the company, functioned as chief of quality control, did all of the purchasing of materials, machinery, and tools, did the bidding for customers, and kept up customer relations, as well as supervising production. In the performance of these duties Will Flitcroft worked long hours, six days and sometimes seven days a week. (R. 219-220.)

In June of 1952 Will Flitcroft became acquainted with Richard H. Miers (hereinafter referred to as Miers), when Miers was sent to the plant of Western Hydraulic by his employer (who was doing accounting work for the partnership) to make a running audit of the partnership's books. Subsequent to the time that Miers made this running audit Will Flitcroft terminated the services of the accounting firm by which Miers was employed, engaged and then discharged another certified public accountant to do the work for Western Hydraulic, and then about July, 1952, engaged Miers to keep the books and records of the partnership. The partnership paid Miers the prevailing fee of \$60 per day for his services. (R. 220.)

After Western Hydraulic engaged Miers to render accounting services for it, Will Flitcroft and Miers discussed from time to time the advantages which taxpayers might derive through the creation of trusts for the benefit of their two minor children and the inclusion of these trusts in the partnership. On November 6, 1952, Miers wrote a letter to taxpayers sug-

gesting that the partnership, Western Hydraulic, composed of taxpayers, be dissolved on December 31, 1952, and that a new partnership be formed on January 1, 1953, composed of taxpayers and their two minor children, Johnel A. Flitcroft and William R. Flitcroft. (R. 220.)

Sometime in November, 1952, a meeting was held at taxpayers' home at which the taxpayers, their children, aged 10 and 12 years, Miers, and an attorney were present. The attorney who was present, Frederick L. Botsford, had been an acquaintance of Miers for some time and Miers had recommended him to Will Flitcroft. The result of the meeting held in November, 1952, was a decision to create a 10-year trust for each of taxpayers' minor children, to which trusts one-half of taxpayers' interest in Western Hydraulic was to be conveyed. A new partnership was to be formed that would be composed of taxpayers and the trusts for their two minor children. Miers was to be appointed sole trustee of the trusts because Will Flitcroft had confidence in him. An agreement dated December 31, 1952, dissolving the partnership, Western Hydraulic, was executed by taxpayers on a date not shown in the record. (R. 221.)

Sometime after January 1, 1953, taxpayers and Miers executed two agreements dated January 1, 1953, identical except as to the beneficiary named therein, each entitled "trust agreement" and each stating in part as follows (R. 221-222):

This Trust Agreement is entered into between  
WILL FLITCROFT and AGNES DOROTHY

FLITCROFT, husband and wife, as the Trustors, and RICHARD H. MIERS, as the Trustee.

The Trustors have transferred and delivered to the Trustee, without any consideration on their part, the property described in the attached "Schedule A", which is a part of this Trust Agreement, the receipt of which is hereby acknowledged by the Trustee. The said property, together with any other property that may later become subject to this Trust, shall constitute the trust estate, and shall be held, administered and distributed by the Trustee as provided herein.

#### ARTICLE I

The Trustors shall have the right at any time to add to this Trust other property acceptable to the Trustee, which additional property, upon its receipt and acceptance by the Trustee, shall become a part of the Trust estate.

Article 2 of the trust provided for broad powers of management of the trust corpus by the trustee. Article 3 provided for the accumulation by the trustee of the net income of the trust during the term of the trust, except that under certain circumstances, in the absolute discretion of the trustee, payment of all or a portion of the income could be made to the beneficiary of the trust. It also provided that the trust should cease and terminate on January 6, 1963; that upon termination the trustee should pay to the beneficiary the net income of the trust estate then remaining and should deliver and return to the trustors all of the property then remaining that they had transferred and delivered under the trust to the trustee and



any property then in the hands of the trustee which had been acquired by him from the sale or other disposition of the property transferred and delivered to him by the trustors. Article 4 provided that the beneficiary should have no right to alienate his or her interest in the trust. Articles 5 and 6 provided for the appointment of a successor trustee should the trustee resign and for the fees to be paid to the trustee. Article 7 of the trust agreement provided as follows (R.222):

This Trust has been accepted by the Trustee and will be administered in the State of California, and its validity, construction and all rights thereunder shall be governed by the laws of that State. If any provision of this Trust Agreement should be invalid or unenforceable, the remaining provisions thereof shall continue to be fully effective.

Attached to each of the trust agreements was a statement of the assets, liabilities, and net worth of the partnership, Western Hydraulic, as of December 31, 1952. (R. 223.)

At the same time that the trust agreements were executed taxpayers and Miers (as trustee for each of the two trusts) executed an agreement entitled "agreement of partnership", which agreement stated that it was made the first day of January, 1953, and provided that the name of the partnership should be Western Hydraulic and Service Company and that the terms of the partnership should begin on January 1, 1953, and should end on December 31, 1963. It provided that the capital contribution should consist of the assets subject to the liabilities (as shown

on an attached statement of assets and liabilities), and further provided that the assets should belong to each of the parties equally. To do this each of the parties assigned to the others an undivided equal one-fourth interest of the assets shown on the attached statement. The capital contribution of each partner was to consist of his or her interest in the assets (subject to liabilities) of the agreed net value of \$315,530.01 in which each partner owned an undivided one-fourth interest. (R. 223-224.)

The partnership agreement also provided that Will Flitcroft should be general manager of the partnership at a minimum salary of \$25,000 a year, to be paid from the partnership funds, and that Agnes D. Flitcroft should at all times make her services available to the partnership for secretarial work at a minimum salary of \$3,000 per year. Net profits or losses after the payment of salaries to taxpayers were to be divided equally among the partners and the account of each credited or debited with his or her proportionate share thereof. Any party might withdraw his or her share of the net profits at the end of any year and any profits not withdrawn were to bear interest at the rate of 6 percent. The death of a party or a beneficiary of one of the trusts would not terminate the partnership, but the partnership would continue for the then remaining unexpired term, and the personal representative of the deceased would receive the deceased person's interest in the partnership and his or her share of the net profits or losses. (R. 224.)

On May 12, 1954, a certificate of business fictitious Firm Name was filed in the office of the county clerk

of Los Angeles County, California, in which it was stated that the firm of Western Hydraulic was composed of the following persons: Will Fliteroft, Agnes Dorothy Fliteroft, and Richard H. Miers, as trustee for William R. Fliteroft and Johnel Ann Fliteroft. (R. 225.)

Capital was a material income-producing factor in the partnership, Western Hydraulic. (R. 225.)

Taxpayers were motivated, in executing the trusts for their two minor children and the partnership agreement with Miers as trustee of each of these trusts, by a desire to save taxes (part of the anticipated partnership income distributable to the trusts), a desire to create a separate estate for their children, a desire to have the share of the profits attributable to the two trusts remain for use in the partnership business, and a desire to interest the children in the business of the partnership as they matured in years. (R. 225.)

Will Fliteroft had also concluded that it would be advantageous to have Miers do the accounting work for Western Hydraulic and to help operate the business. During the years 1953 through 1956 Miers spent most of his time in connection with the business of Western Hydraulic. He took charge of production control, accounting, contract negotiations, renegotiation of Government contracts, and cost records. He also handled labor relations for the partnership and served as its controller, as well as working with the sales and engineering departments on the submission of bids for contracts. He hired office personnel and dealt directly with customers of Western Hydraulic.



During the years 1953 through 1956 Miers was paid a fee of \$60 per day or approximately \$900 per month for the services he rendered Western Hydraulic. (R. 225-226.)

Sometime in 1953 or prior thereto Will Flitcroft recognized that the premises then occupied by Western Hydraulic had become too small for the operation in which the company was then engaged. In March or April, 1953, taxpayers acquired a 60 percent interest in a parcel of real estate known as 1510 West 135th Street, Gardena, California. The owners of the other 40 percent interest in this property were John O. Best and his wife. Will Flitcroft sold the building he owned at 70th and Central Avenue, Los Angeles, California, which was occupied by Western Hydraulic, and a factory building suitable for use by Western Hydraulic was built on the property on West 135th Street acquired by taxpayers and the Bests. Western Hydraulic moved into this new building upon its completion about November 1, 1953. On September 15, 1953, a lease agreement was executed between taxpayers and the Bests as lessors and Western Hydraulic as lessee, under the terms of which it was agreed that Western Hydraulic would lease the improved property for a period of 10 years commencing October 1, 1953, and terminating September 30, 1963, for a monthly rental of \$1,600, of which Western Hydraulic would pay \$960 to taxpayers and the remaining \$640 to the Bests. (R. 226.)

On or about October 1, 1953, taxpayers and Miers executed an agreement dated October 1, 1953, entitled "trust agreement", naming taxpayers' two minor chil-

dren as beneficiaries. The provisions of this trust agreement, except as to the named beneficiaries and commencement and termination dates, were the same as those of the two separate trusts dated January 1, 1953, created by taxpayers for their two minor children. Under date of October 1, 1953, taxpayers conveyed, by quitclaim deed, their 60 percent interest in the property at 1510 West 135th Street, Gardena, California, to Miers as trustee, and also assigned their interest as lessors under the lease of the premises to the trust. The trust, as stated in the trust agreement, was to terminate on October 6, 1963. (R. 226-227.)

On January 1, 1957, the business of Westren Hydraulic was incorporated. At the time of incorporation, each of the trusts dated January 1, 1953, received 5,000 shares of stock of the corporation, such shares having a total value of \$120,000, and in addition each trust received \$70,000 of notes of the new corporation. (R. 227.)

On April 15, 1954, taxpayers, individually, filed federal gift tax returns for the year 1953, which are identical except as to the name of the taxpayer, each return indicating that the filer thereof made two gifts during the year totaling \$31,633.94, comprising the stated \$22,954.81 "gift" to the trusts stated to have been created on January 1, 1953, and the \$8,679.13 "gift" stated to have been made to the trust created on October 1, 1953. (R. 227.)

Taxpayers also filed gift tax returns with the State of California for the year 1953, reporting thereon gifts made to each of their children in trust, in the

total amount of \$35,268.69. (R. 227.) Under date of June 29, 1954, taxpayers' attorney received a letter from the office of the Controller of the State of California, Chief Inheritance Tax Attorney (R. 227-228), which stated (R. 228):

We have examined the trusts executed by the above named donors \* \* \* [taxpayers], and are wondering whether at the time of the execution, they had in mind Section 2280 of the Civil Code.

It appears to us that in view of this section, the trusts are revocable, and that no gift tax is due. May we have your thoughts on this point?

Under date of July 21, 1954, taxpayers' attorney replied to this letter as follows (R. 228):

When the trusts were prepared and executed by the Donors \* \* \* [taxpayers] consideration was not given to the effect of Section 2280 of the Civil Code.

It was and is the intention of the Donors \* \* \* [taxpayers] that the Trusts should be irrevocable and therefore I will prepare and have signed by them (and furnish you with a true copy), an amendment to the Trust Indentures making the Trusts irrevocable and waiving any rights the Donors \* \* \* [taxpayers] might have to revoke the same under said Section 2280.

I trust this will remedy the situation and the Trusts will then qualify for gift tax purposes.

Taxpayers and Miers executed an amendment, dated July 30, 1954, to each of the three trust agreements, which provided as follows (R. 228-229):



WHEREAS, it has been called to the attention of the trustors that, under Section 2280 of the Civil Code of the State of California, said trust may be revocable because it is not by its terms made expressly irrevocable; and

WHEREAS, it was, always has been and is the expressed intention of First Parties \* \* \* [taxpayers] that said trust should be irrevocable.

NOW, THEREFORE, IT IS MUTUALLY AGREED between the parties hereto as follows:

There is hereby added to Article 7 on Page 4 thereof the following:

This trust is by the trustors, hereby expressly made irrevocable.

Under date of September 10, 1954, the office of the Controller of the State of California, Inheritance and Gift Tax Division, issued a Notice and determination of gift tax, determining that each taxpayer made net taxable gifts to each of their children in the year 1953 in the total amount of \$35,268.69. (R. 229.)

Taxpayers, Miers and Frederick L. Botsford executed an amendment to <sup>the</sup> trust agreement dated December 1, 1954, whereby Botsford became the cotrustee with Miers for the three trusts. Miers, as trustee of the two individual trusts, consulted with taxpayers as to the management of Western Hydraulic. In addition Miers, as trustee and cotrustee of each of the three trusts, kept the books and records for the trusts, prepared and filed federal and State of California fiduciary income tax returns for the trusts, and prepared and signed checks for income taxes and trustees' fees on behalf of the trusts. Botsford's acts as co-

trustee for each of the three trusts were limited to legal matters connected with the trusts. Separate bank accounts and capital accounts were kept for each of the three trusts. Taxpayers have never received any income from the trusts. (R. 230.)

On or about November 7, 1958, Botsford and Miers, as trustees of the Flitercroft trusts, and taxpayers' two minor children by a guardian *ad litem*, filed a complaint in the Superior Court of the State of California in and for the County of Los Angeles against taxpayers and Robert A. Riddell, District Director of Internal Revenue, requesting that a declaratory judgment be entered, declaring and adjudicating the respective rights of the plaintiffs and defendants pertaining to the written instruments attached thereto (the two documents entitled "trust agreement" dated January 1, 1953, together with amendments thereto). The complaint stated that the defendant Robert A. Riddell, District Director of Internal Revenue, had refused to recognize the amendments to trust agreements executed on or about July 30, 1954, as being effective, and had refused to recognize that the trust agreements dated January 1, 1953, constituted irrevocable trusts. The defendant Robert A. Riddell petitioned for removal of the action brought against him to the United States District Court for the Southern District of California, Central Division, which petition was granted, and the action against Riddell was dismissed by the District Court. Upon appeal, the dismissal was affirmed by the United States Court of Appeals for the Ninth Circuit, *Botsford v. Riddell*, 283 F. 2d 298. After the affirmance the remaining

parties stipulated and agreed that the matter should be remanded to the Superior Court of the State of California in and for the County of Los Angeles for further proceedings. (R. 230-231.) On November 13, 1961, the Superior Court of the State of California in and for the County of Los Angeles entered the following order (R. 231):

IT IS ORDERED, ADJUDGED, AND DECREED that the Trust Agreements, dated January 1, 1953, executed by the defendants Will Fliteroft and Agnes D. Fliteroft, as trustors, and by the plaintiff Richard H. Miers, as trustee, copies of which are attached to the complaint on file herein marked as Exhibit A and B, be and they hereby are reformed in accordance with the express intent of the trustors and trustee so that the following sentence is added to the first paragraph of each of said Trust Agreements: "This Trust is irrevocable."

IT IS FURTHER ORDERED AND DECREED that said Trust Agreements were irrevocable upon their date of execution, January 1, 1953, and the respective rights and obligations of the parties arising from said agreements shall be governed accordingly.

Western Hydraulic filed federal partnership returns of income for the calendar years 1954, 1955 and 1956, reporting its income and deductions on an accrual basis of accounting. On the partnership return for the year 1954 there was reported a loss on the sale of land and building located at 6920 South Central, Los Angeles, California. On the partnership returns of income of Western Hydraulic for the years 1954, 1955, and 1956, ordinary net income was reported in

the amount of \$114,658.52, \$56,726.87, and \$69,537.67, respectively. (R. 231-232.) The ordinary net income reported on the returns of Western Hydraulic was allocated thereon as follows (R. 232):

Name of partner	1954	1955	1956
Will Flitcroft.....	<sup>1</sup> \$37,414.63	\$14,181.72	\$17,384.41
Agnes D. Flitcroft.....	<sup>1</sup> 37,414.63	14,181.72	17,384.42
J. A. Flitcroft Trust.....	19,914.63	14,181.71	17,384.42
W. R. Flitcroft Trust.....	19,914.63	14,181.72	17,384.42
	\$114,658.52	\$56,726.87	\$69,537.67

<sup>1</sup> These amounts include the \$17,500 of salaries of taxpayer not included in the subsequent years.

Withdrawals were made from Western Hydraulic during the years 1954, 1955, and 1956 against the capital accounts of the trusts as follows (R. 232):

Year	Withdrawal from	
	Johnel trust	William trust
1954.....	\$8,052.05	\$8,052.05
1955.....	4,938.18	4,938.18
1956.....	1,614.32	1,609.93

The only expenditures made on behalf of the two trusts during the years 1954, 1955, and 1956 were for federal and State income taxes and trustees' fees, and in 1954 and 1955 for charitable contributions. Except for the amounts withdrawn, the partnership income allocated to the two trusts was credited to the capital accounts of these trusts on the partnership's books and kept in the business of the partnership as additional operating capital. (R. 232-233.)

Western Hydraulic claimed rental expense deductions on its federal partnership returns of income for the years 1954, 1955, and 1956 in the respective amounts of \$22,392.83, \$19,200, and \$19,200, which



amounts were stated to have been paid as rental for the factory located at 1510 West 135th Street, Gardena, California. (R. 233.)

Each of the trusts created for taxpayers' children (individually) filed federal income tax returns for the year 1954 and subsequent years on a calendar year basis. The trust created for taxpayers' children (jointly) filed a federal income tax return for a fiscal year December 1, 1953, to December 1, 1954. (R. 233.)

The Commissioner of Internal Revenue in his notices of deficiency for the years 1954, 1955, and 1956 increased taxpayers' income in each year by including therein the total amount of the net income of the partnership, Western Hydraulic. In determining the net income of Western Hydraulic to be included in taxpayers' income, the Commissioner increased the amount of such income as reported on the partnership returns of income by 60 percent of the rental deduction for the factory at 1510 West 135th Street, Gardena, California, claimed by the partnership. In each instance the Commissioner disallowed the claimed deduction for rent on the ground that the amount claimed to be paid to the trust for taxpayers' minor son and daughter was not a deductible business expense of the partnership; and the Commissioner included the total income of the partnership in the taxpayers' taxable income on the ground that no recognition should be given to the trusts as partners for federal income tax purposes. (R. 233.) The Tax Court upheld the deficiencies as determined by the Commissioner. (R. 258-261.)

## SUMMARY OF ARGUMENT

The only issue on this appeal is whether the income of the three trusts created by taxpayers in behalf of their two minor children is includible in taxpayers' gross income in the years 1954, 1955, and 1956. Under Section 673(a) of the Internal Revenue Code of 1954, a grantor of a trust who retains a reversionary interest is taxable on the income of the trust unless he irrevocably surrenders his right to the income of that trust for a period of at least 10 years. The three trusts in this case were created for periods of a few days in excess of 10 years, but because the trusts when created were revocable under California law, their income was taxable to the taxpayers-grantors.

Section 2280 of the Civil Code, 10 West's Annotated California Codes, provides that a voluntary trust—one created, under decisions of the California state courts, without consideration—is revocable unless the instrument creating it expressly provides that the trust is irrevocable. Since the three trusts here were voluntary and did not contain such a provision, they were revocable. The trusts were subsequently amended and made irrevocable, but at the time they were amended, they had less than 10 years to run. Consequently their income was includible in taxpayers' gross income.

Taxpayers argue that the trusts were not voluntary trusts because taxpayers created them to secure the services of the trustee Miers in their partnership business, and that therefore the trusts were for their own benefit, not for their children's. This argument hardly merits refutation; it strains credulity to be-



lieve that taxpayers would create the three trusts only as a means of obtaining the services of Miers in their business. Other ways of effecting that result certainly were both possible and preferable. The minimal compensation provided by the trusts for the trustee, the testimony of Will Fliteroft that he chose Miers as trustee because of Miers' interest in the children, the nature of the trusts themselves, and the fact that the trusts expressly state that they were created without consideration, all contradict taxpayers' argument and support the Tax Court's conclusion that these trusts were voluntary trusts created in behalf of taxpayers' children and therefore revocable.

Taxpayers also contend that the trusts were irrevocable for over ten years because of the state court judgment which reformed the trusts to make them irrevocable and which specifically made the reformation retroactive to the date the trusts were created. The state court judgment, however, was rendered seven years after taxpayers were informed that their trusts were revocable, at a time when the only important effect of the reformation would be on taxpayers' federal tax liability. In light of the additional significant fact that the state court judgment was rendered on the pleadings—without any hearing, despite an inconsistency between the complaint and the evidence known to the parties as to why the trusts did not contain the necessary phraseology of irrevocability—it is clear that the judgment was nothing more than a consent decree—collusive in fact—and therefore was not binding on the federal courts under decisions of this Court and other Courts of Appeals.

That the state court proceeding was instituted as an action for declaratory judgment, an action which under California law requires an actual controversy, is not significant here because the issue of actual controversy was never raised and because the evidence convincingly shows that there was no *bona fide* dispute between the parties. Finally, a reformation of the kind secured here, obtained long after the taxable years in question, cannot operate so as to defeat the rights of the Federal Government which had already accrued.

Nor is there any merit to taxpayers' contention that Section 673(a) of the 1954 Code and the corresponding Regulations promulgated under the Internal Revenue Code of 1939 are unconstitutional. Taxpayers rely on *Commissioner v. Clark*, 202 F. 2d 94 (C.A. 7th). This case is completely distinguishable from the instant case because in *Clark* the court specifically found that the trusts were 10 year trusts and because in *Clark* the Commissioner of Internal Revenue was applying the Regulations promulgated under the 1939 Code to trusts created prior to date of promulgation. In the instant case the Regulations had been in effect for seven years before the trusts were created.

Thus the statement of the Seventh Circuit that the Regulations and even a statute taxing grantors of reversionary trusts for less than 10 years are unconstitutional is mere dictum, a dictum which this Court should not follow. The so-called Clifford Regulations and the short-term trust provisions of the 1954 Code were passed after an invitation made by the Supreme

Court in *Helvering v. Clifford*, 309 U.S. 331, and repeated in *Harrison v. Schaffner*, 312 U.S. 579, to the Congress and the Treasury to provide precise, fixed rules in the area of the taxation of grantors of trusts short in duration and over which the grantors may also have retained a certain measure of dominion and control. The response of both the Congress and the Treasury taxing grantors of reversionary trusts lasting less than 10 years was not unreasonable. The period of time was not too long, particularly because several Courts of Appeals had already upheld the taxation of grantors of trusts lasting about 10 years. The automatic taxation of grantors of such trusts, instead of the prescription of a rebuttable presumption, as advocated by the Seventh Circuit, was in accord with the invitation of the Supreme Court in *Clifford* to lay down "precise" guidelines which would obviate the need for a case by case determination by the judiciary. Neither the statute nor the Regulations, in view of the leeway to be granted legislative and administrative judgment, should, therefore, be held unconstitutional.

#### ARGUMENT

**The Tax Court correctly held that the income of the three trusts created for the benefit of their children was includible in taxpayers' gross income in the years 1954, 1955, and 1956**

The only issue presented on this appeal is whether the Tax Court correctly held that the income of the three trusts created by the taxpayers for the benefit of their two minor children was includible in the tax-



payers' gross income in the years 1954, 1955, and 1956.<sup>1</sup>

Although these three trusts were created in 1953, the taxability of the income they received in 1954, 1955, and 1956 is, pursuant to Section 683(a) of the Internal Revenue Code of 1954, Appendix, *infra*,

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<sup>1</sup> The income of the joint trust for the minor children consisted of rent paid to it by the partnership. The notices of deficiency from the Commissioner to the taxpayers did not include these rental payments in taxpayers' gross income but instead disallowed to the partnership the deduction it claimed for the rental paid to the joint trust. (R. 23, 37.) This disallowance, of course, increased the net income of the partnership and therefore increased the distributive share of the taxpayers-partners' own income. Section 701 and Section 702 of the Internal Revenue Code of 1954. In his opening brief in the Tax Court, the Commissioner adopted a new legal theory when he stated:

The broad question presented for the Court's determination in these consolidated cases is whether partnership income reported by *three* trusts created by petitioners [taxpayers] for the benefit of their two children is taxable to petitioners in the years 1954, 1955, and 1956. (Emphasis supplied.)

Nowhere in his brief did the Commissioner attempt to justify the disallowance of the rental deduction to the partnership. In their reply brief in the Tax Court, taxpayers, strangely enough, did not discuss nor even mention the Commissioner's new theory.

In its opinion, the Tax Court recognized the Commissioner's new theory when it stated his position in the case exactly as he had stated it in his opening brief. (R. 234.) Moreover, in its opinion, it never discussed the correctness of the Commissioner's disallowance of the rental deduction in the notices of deficiency. Its decision upholding the deficiencies asserted by the Commissioner was clearly based on the inclusion of the rental payments to the joint trust in taxpayer's gross income, not on the disallowance to the partnership of the deductions for rental payments.

Nevertheless, in their brief in this Court, taxpayers have failed to acknowledge both the Commissioner's adoption of a

governed by the special trust provisions of the 1954 Code, except for the income earned by the joint trust in the fiscal year, December 1, 1953, to December 1, 1954, the taxability of which is governed by the Internal Revenue Code of 1939 and the Regulations promulgated thereunder.<sup>2</sup> The application of these

new theory and the Tax Court's acceptance of this theory with respect to the income of the joint trust and instead have challenged the disallowance of the deduction of the rental payments. (Br. 31, 56-59.) This challenge, however, is not responsive to the opinion and decision of the Tax Court. In adopting a new legal theory in his opening brief, the Commissioner sought only to uphold the deficiency he had asserted in the notices of deficiency on a different basis; he never made any attempt to increase the deficiency. Thus, instead of disallowing to the partnership the deductions for rent and thereby increasing both its net income and taxpayers' distributive share of this income, the Commissioner allowed the rental deduction to the partnership but included the rental payments to the joint trust in taxpayers' gross income. The resulting increase in taxpayers' gross income was the same as under the Commissioner's original theory; the only difference was the theory justifying the increase. All the facts relevant and material to this new theory were before the Tax Court in the exhibits and testimony, particularly because the question of whether the income of the joint trust was includible in taxpayers' gross income was similar to the question of whether the income of the other two trusts was includible in taxpayers' gross income. Consequently, taxpayers were not placed at any disadvantage by the Commissioner's adoption of a new theory and the Tax Court's acceptance of it. Accordingly, any complaint they may subsequently make, especially in light of their failure to complain to the Tax Court itself, is without merit. *Anderson v. Commissioner*, 156 F. 2d 591 (C.A. 2d); *Irish v. Commissioner*, 129 F. 2d 468 (C.A. 3d); *Moore v. Commissioner*, 202 F. 2d 45 (C.A. 5th).

<sup>2</sup> The pertinent provisions of the 1939 Code and the Regulations, however, are, for the purpose of this case, identical to the pertinent sections of the 1954 Code. Thus, compare Section 166

special trust provisions of the 1954 Code to income received by these pre-1954 trusts in 1954, 1955, and 1956 by Section 683(a) is valid, even as to that income received in 1954 prior to the enactment of the 1954 Code. *Reinecke v. Smith*, 289 U.S. 172, 175.

Under Section 673(a) of the 1954 Code, Appendix, *infra*, the income of a trust is taxable to the grantors if they retain a reversionary interest which may be expected to take effect in 10 years. The taxpayers in this case retained a reversionary interest in the trusts they created, but each of the trusts they created was to last for a few days in excess of 10 years. (Art. III (B), Exs. 5, 6, 20.) Taxpayers, however, are not therefore relieved of taxability under Section 673(a) because this provision must be correlated with Section 676(a), Appendix, *infra*. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. A217 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4356); S. Rep. No. 1622, 83d Cong., 2d Sess., p. 370 (3 U.S.C. Cong. & Adm. News (1954), 4621, 5012). Under this section, grantors of a trust are taxable on the trust's income if they have a power of revocation, unless, under Section 676(b), Appendix, *infra*, the power of revocation cannot be exercised for a period of time which would exempt them under Section 673. The net effect of these two sections, therefore, is that, for grantors to be nontaxable on the income of a trust under Section 673(a), they must have irrevocably surrendered all right to reinvest themselves with the income of the trust for

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of the 1939 Code, to Section 676(a) of the 1954 Code, and Treasury Regulations 118 (1939 Code), Sec. 39.22(a)-21(c)(i), to Section 673(a) of the 1954 Code.



a period of 10 years, an interpretation consistent with the Committee Reports which state (H. Rep. No. 1337, *supra*, p. 63 (3 U.S.C. Cong. & Adm. News (1954), p. 4089); S. Rep. No. 1622, *supra*, p. 87 (3 U.S.C. Cong. & Adm. News (1954), p. 4719):

Under your Committee's bill, the grantor is not to be taxed by reason of a reversionary interest in an *irrevocable* trust unless the reversion may occur within 10 years. (Emphasis supplied.)

The question to be resolved in this case, accordingly, is whether the three trusts created by the taxpayers here were irrevocable for 10 years. The Tax Court held that they were *not*. Its holding, we submit, is correct and should be sustained.

Each of the three trusts involved in this case was by its terms to be administered in the State of California and its validity and construction governed by the laws of that State. (Exs. 5, 6, 20.) Section 2280 of the Civil Code, 10 West's Annotated California Codes, Appendix, *infra*, specifically provides that every voluntary trust shall be revocable by the trustor by a writing filed with the trustee unless expressly made irrevocable by the instrument creating it. Since none of the three trust instruments contained a provision expressly making them irrevocable (Exs. 5, 6, 20), under California law they were revocable trusts until amended to be irrevocable on July 30, 1954 (Exs. 7, 8, 21). At this time, however—July 30, 1954—none of the trusts had 10 years to run. Accordingly, though the trusts were irrevocable in the taxable years in question—1954, 1955, and 1956—the income of these trusts was taxable to taxpayers under Section 673(a)

because none of the trusts was or ever had been irrevocable for a period of 10 years, as that section requires.

Taxpayers offer several arguments against this conclusion. Examination of these arguments, however, reveals that they are without merit.

1. Taxpayers claim (Br. 40-48) that Section 2280 of the California Civil Code is not applicable to these trusts. The reason for this, taxpayers continue, is that when these trusts are considered together with the partnership agreement (Ex. 17), it becomes clear that they were created for taxpayers' own benefit and therefore were not voluntary trusts as defined in *Touli v. Santa Cruz County Title Co.*, 20 Cal. App. 2d 495, 67 P. 2d 404. The same contention has been raised by other taxpayers and has been specifically rejected by this Court which has held trusts similar to those in this case to be revocable under California law. *Newman v. Commissioner*, 222 F. 2d 131, 136; *Gaylord v. Commissioner*, 153 F. 2d 408, 414. See also *Krag v. Commissioner*, 8 T.C. 1091, 1097.

Moreover, the evidence here overwhelmingly supports the Tax Court's conclusion (R. 239) that the trusts in this case were voluntary. *Touli* defines a voluntary trust as one created without a valuable consideration. The trust instruments themselves (Exs. 5, 6, 20) specifically state in the introduction that the trusts were created "without any consideration." Will Fliteroft testified that he received no consideration (R. 142) and Miers, the trustee, testified that he gave none (R. 191). Furthermore, for the year in which the trusts were created, taxpayers

filed federal gift tax returns (Exs. 29–I and 30–J) and a gift tax return with the State of California (R. 227), a persuasive indication here that they intended to make a gift—that the trusts were created, not for their own benefit, but for their children’s.

Despite these facts, taxpayers insist that they created the trusts for the purpose of securing the services of Miers—the trustee—for their partnership business and in support cite (Br. 47) the Tax Court’s findings (R. 225–226) that Miers was of great assistance to the partnership. We do not question the value of Miers to the partnership business, but point out that for these services he was paid \$60 a day. (R. 187.) Moreover, taxpayers’ claim that they gave their children one-half of their partnership business for 10 years and ownership of property and a lease on which the partnership building was located, to obtain the services of Miers as trustee for the partnership business (especially in light of the minimal compensation he was to receive *as trustee* (Art. VI, Exs. 5, 6, 20)), strains credulity far and above its breaking point. The claim also is inconsistent with the testimony of Will Flitcroft that he made Miers trustee because he “thought he would be a real good man to have as trustee for my children. He had an interest in my children.” (R. 132.) The Tax Court, therefore, soundly rejected taxpayers’ claim and instead reached the sensible conclusion (R. 239) that these trusts were created for the benefit of taxpayers’ children, were without consideration, and therefore were revocable under California law. *Title Ins. & Trust Co. v. McGraw*, 72 Cal. App. 2d 390, 164 P. 2d 846; *Gaylord*



v. *Commissioner, supra*; *Newman v. Commissioner, supra*.

2. Taxpayers next urge (R. 52) that, if the two single trusts were revocable when created, they were reformed and made irrevocable from the date of their execution pursuant to a state court judgment. (Ex. 13), a judgment, which, they also urge, is binding upon the federal courts.<sup>3</sup> Contrary to taxpayers' claim, however, the judgment they secured is not binding upon the federal courts since, as the Tax Court found (R. 240) and as the evidence shows, this state court judgment was collusive.

First of all, the only significant reason for taxpayers' securing the order of reformation more than 7 years after they were informed that their trusts were not irrevocable under California law (Ex. 31-K), notwithstanding their protestations and their suggestion of other possible, but not persuasive, reasons, was to try to reduce their federal tax liability. This was especially true once the District Director succeeded in having himself dismissed as a party to the suit, after which all the parties in control of the litigation were seeking the same result. Secondly, the complaint in the suit, to which, as the state court declared (Ex. 13), no sufficient answer was made, alleged that reformation was necessary because the scrivener mistakenly omitted from the trust instru-

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<sup>3</sup> There is no evidence in this case that the joint trust was ever reformed by a state court judgment. It was amended on July 30, 1954 (Ex. 21), but, as we have already explained, this amendment and the amendments of the two other trusts on the same date (Exs. 7, 8, 21) do not enable taxpayers to escape the effect of Section 673(a).

ments the sentence: "This trust is irrevocable" (Ex. 11, p. 10). Yet, when taxpayers were first informed by the California state comptroller's office that the trusts were not irrevocable because of Section 2280 of the Civil Code (Ex. 31-K), their attorney replied (Ex. 32-L):

When the trusts were prepared and executed by the Donors consideration was not given to the effect of Section 2280 of the Civil Code.

Since Section 2280 requires that a trust expressly state that it is irrevocable, this statement of taxpayer's attorney is difficult to reconcile with the allegation in their complaint that the scrivener mistakenly omitted this key phrase. When this inconsistency is considered together with the anticipated tax savings attributable to the trusts, the late date at which the order of reformation was secured, and the fact that the judgment was rendered on the pleadings without hearing (Ex. 13), it becomes perfectly clear that the judgment secured was in the nature of a consent decree and, as this Court has explained in an earlier case involving another belated attempt of grantors of a trust governed by California law to reform their trust instrument (*Newman v. Commissioner*, 22 F. 2d 131, 136)—

was collusive in the limited and special sense that all parties joined in the submission of the issues and sought a decision which would adversely affect the tax rights of the government.

Such an order, this Court held, is not binding on a federal court. See also, *Wolfson v. Smyth*, 223 F. 2d 111, 113-114 (C.A. 9th), certiorari denied, 352 U.S.

878; *Faulkerson's Estate v. United States*, 301 F. 2d 231, 232-233 (C.A. 7th), certiorari denied, 371 U.S. 887; *In re Sweet's Estate*, 234 F. 2d 401, 404 (C.A. 10th). Certainly, in light of the evidence outlined in the preceding paragraph, the Tax Court's resolution of this factual question (*Merchants National Bank & Trust Co. v. United States*, 246 F. 2d 410, 417 (C.A. 7th), certiorari denied, 355 U.S. 881, rehearing denied, 355 U.S. 920) was not clearly erroneous (*Commissioner v. Duberstein*, 363 U.S. 278, 291).

Taxpayers seek to counter the Tax Court's finding of collusiveness in the state court proceedings with two arguments. First, they point out that the suit was brought as an action for a declaratory judgment under Section 1060 of the Code of Civil Procedure, 18 West's Annotated California Codes, Appendix, *infra*. Because Section 1060 requires that there be an actual controversy before the court can render a declaratory judgment, taxpayers argue that the very fact that the state court did render judgment proves conclusively the existence of a *bona fide* adversary proceeding. The question, however, of whether there was an actual controversy was not raised in the state court proceeding and consequently was never passed upon. Moreover, as we have already demonstrated, there was no *bona fide* dispute between the parties here, with one side opposing the position of the other, as required by California decisions. See, *Maxwell v. Brougher*, 99 Cal. App. 2d 824, 828, 222 P. 2d 910, 922; *Gillies v. LaMesa Etc. Irr. Dist.*, 54 Cal. App. 2d 756, 762, 120 P. 2d 941, 944. Thus, the fact that the state court did render judgment in a suit brought



for declarative relief does not, in the circumstances of this case, prove the existence of a *bona fide* adversary proceeding.<sup>4</sup>

Taxpayers also urge (Br. 52-54) that their suit was a suit for reformation which did not require a *bona fide* adversary proceeding since it was instituted only to correct a mutual mistake. But the reformation cannot occur in such a way as to defeat the already accrued rights of a third party—in this case the United States. Here the reformation order was granted in November, 1961, long after taxpayers' tax liability on the income of the trusts in 1954, 1955, and 1956 had become fixed. Insofar as the order adversely affected the tax rights of the Government, the Tax Court properly refused to give it effect. *M. T. Straight's Trust v. Commissioner*, 245 F. 2d 327 (C.A. 8th); *Sinopoulo v. Jones*, 154 F. 2d 648 (C.A. 10th).<sup>5</sup>

3. As a last resort, taxpayers claim (Br. 35) that Section 673(a) of the 1954 Code, and Treasury Regulations 118 (1939 Code), Sec. 39.22(a)-21(c), Appendix, *infra*, are unconstitutional. In so doing, they

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<sup>4</sup> This is so notwithstanding Section 1061 of the California Code of Civil Procedure, under which a court may dismiss a suit for declaratory judgment if it is premature. The language of this section is permissive and in no way requires a California court to raise, on its own accord, the issue of whether there is an actual controversy.

<sup>5</sup> Section 3399 of the Civil Code, 12 West's Annotated California Codes, cited by taxpayers as supporting their claim for retroactive reformation (Br. 52-54), is not applicable because it refers to a "written contract". The voluntary trusts in this case (Exs. 5, 6, 20) were not written contracts. *Gaylord v. Commissioner*, 153 F. 2d 408, 415 (C.A. 9th).

rely on *Commissioner v. Clark*, 202 F. 2d 94 (C.A. 7th). The *Clark* case, however, is readily distinguishable from this case. As a preliminary matter, the court in *Clark, supra*, p. 98, held that the trusts in that case were 10-year trusts. Thus, the court had no need to examine the validity of the Regulations. Furthermore, in *Clark*, the Commissioner was applying the Clifford Regulations,<sup>6</sup> which were promulgated on December 29, 1945, and made applicable to taxable years commencing January 1, 1946, to trusts created before the Regulations came into existence. The Court of Appeals for the Seventh Circuit refused to allow this retroactive application. In the instant case, however, the Clifford Regulations, more particularly, Treasury Regulations 118 (1939 Code), Sec. 39.22(a)-21(c), had already been in existence for 7 years when the three trusts were created. Consequently, there was no retroactive application.<sup>7</sup>

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<sup>6</sup> More specifically, the Commissioner was relying on Treasury Regulations 111 (1939 Code), Sec. 29.22(a)-21(c), as added by T.D. 5488, 1946-1 Cum. Bull. 19, a regulation identical to Treasury Regulations 118 (1939 Code), Sec. 39.22(a)-21(c).

<sup>7</sup> By distinguishing the *Clark* case on this basis, however, we are not conceding that the Commissioner cannot constitutionally apply retroactively either the Clifford Regulations under the 1939 Code or the special trust provisions of the 1954 Code to trusts created before the Regulations were promulgated or the short-term provisions of the 1954 Code were enacted. For cases in which such retroactive application has been approved, see *Kay v. Commissioner*, 178 F. 2d 772, 773 (C.A. 3d); *Shapero v. Commissioner*, 165 F. 2d 811, 812 (C.A. 6th).

We also wish to point out that the *Clark* case involved a charitable trust. With respect to the liability of grantors on the income of Clifford trusts, charitable trusts have generally received special consideration from the courts (*Helvering v. Bok*, 132 F. 2d 365, 367 (C.A. 3d), and *Commissioner v.*

Moreover, for all but one year of one of the trusts—the income of the joint trust for the fiscal year December 1, 1953, to December 1, 1954—the Commissioner was asserting his tax under a statute passed by Congress in 1954 to income earned by trusts in 1954, 1955, and 1956. The fact that this statute was applied to trusts created before it was enacted and to income earned by the trusts in 1954 prior to its enactment does not adversely affect its validity. *Reinecke v. Smith*, 289 U.S. 172, 175.

It is true that as dictum in *Clark*, the Court of Appeals for the Seventh Circuit did express its view, that even in the absence of retroactivity, the regulation and even a statute (though at the time of the decision in *Clark* on February 19, 1953, Section 673(a) had not been enacted) automatically taxing to the settlor the income of a less-than-10-year-reversionary-trust was unconstitutional. With this view we respectfully disagree. Even prior to the promulgation by the Treasury of the Clifford Regulations, the Commissioner had taxed the income of short-term trusts to the settlor and been upheld by the Supreme Court in *Helvering v. Clifford*, 309 U.S. 331, and *Harrison v. Schaffner*, 312 U.S. 579, and by the courts of appeals in such cases as *Cory v. Commissioner*, 126 F. 2d 689 (C.A. 3d), and *Commissioner v. Berolzheimer*, 116 F. 2d 628 (C.A. 2d), the latter two cases involving trusts of nearly 10 years duration.

Admittedly the Supreme Court in the *Clifford* case did explain that to decide whether the grantor of a Chamberlin, 121 F. 2d 765, 766 (C.A. 2d)) and from the Congress (Section 673(b) of the 1954 Code).



trust was taxable on its income no one factor was determinative. It is significant, however, that in its opinion in the *Clifford* and *Schaffner* cases, the Supreme Court specifically invited either the Treasury or the Congress to lay down precise standards or guides for solving the problem. *Helvering v. Clifford*, *supra*, pp. 334–335; *Harrison v. Schaffer*, *supra*, pp. 583–584. In this invitation, the Supreme Court did not in any way indicate that Congress or the Treasury would have to formulate rules in terms of rebuttable presumptions, the absence of which made the regulation unconstitutional in the eyes of the Seventh Circuit. *Clark v. Commissioner*, *supra*, pp. 99–100. Rather, the invitation suggested the need for fixed rules so as to avoid the necessity of a case-to-case examination by the judiciary.

Both the Treasury and the Congress ultimately accepted the invitation of the Supreme Court, the Treasury late in 1945 and the Congress in 1954. Both selected a 10-year period as the minimum duration of an irrevocable reversionary trust to permit the grantor to escape taxation on the income of the trust. The length of the period they chose was consistent with the decisions of two courts of appeals upholding the taxation of grantors on the income of trusts to endure 10 years, *Cory v. Commissioner*, *supra*; *Commissioner v. Berolzheimer*, *supra*. Moreover, as the Supreme Court has explained in *Burnet v. Wells*, 289 U.S. 670, 678–679, a case involving the constitutionality of a statute taxing the grantor on the income of trusts set up to pay for insurance policies on the life of the grantor: “A margin must be allowed for the

play of legislative judgment.” Evidently, both the Treasury and the Congress believed that a period of less than 10 years was too short to permit a grantor of a short-term reversionary trust to escape taxation on its income. This Court should not overrule their combined judgment.

#### CONCLUSION

For the reasons given, the decisions of the Tax Court are correct and should be affirmed.

Respectfully submitted.

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AUGUST 1963.

#### CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: \_\_\_\_\_ day of \_\_\_\_\_, 1963.

\_\_\_\_\_,  
*Attorney.*



## APPENDIX

Civil Code, 10 West's Annotated California Codes:

§ 2216. *Voluntary trust defined*

**VOLUNTARY TRUST, WHAT.** A voluntary trust is an obligation arising out of a personal confidence reposed in, and voluntarily accepted by, one for the benefit of another.

§ 2280. *Revocation*

Unless expressly made irrevocable by the instrument creating the trust, every voluntary trust shall be revocable by the trustor by writing filed with the trustee. When a voluntary trust is revoked by the trustor, the trustee shall transfer to the trustor its full title to the trust estate. Trusts created prior to the date when this act shall become a law shall not be affected hereby.

Code of Civil Procedure, 18 West's Annotated California Codes:

§ 1060. *Right of action; actual controversy; scope; effect of declaration*

Any person interested under a deed, will or other written instrument, or under a contract, or who desires a declaration of his rights or duties with respect to another, or in respect to, in, over or upon property, or with respect to the location of the natural channel of a water course, may, in cases of actual controversy relating to the legal rights and duties of the respective parties, bring an action in the superior court for a declaration of his rights and duties in the premises, including a determination of any question of construction or validity arising under such instrument or contract. He may ask for a declaration of rights or duties,

either alone or with other relief; and the court may make a binding declaration of such rights or duties, whether or not further relief is or could be claimed at the time. The declaration may be either affirmative or negative in form and effect, and such declaration shall have the force of a final judgment. Such declaration may be had before there has been any breach of the obligation in respect to which said declaration is sought.

§ 1061. *Refusal to exercise power*

The court may refuse to exercise the power granted by this chapter in any case where its declaration or determination is not necessary or proper at the time under all the circumstances.

Internal Revenue Code of 1939:

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

(26 U.S.C. 1952 ed., Sec. 166.)

Internal Revenue Code of 1954:

SEC. 673. REVERSIONARY INTERESTS.

(a) *General Rule.*—The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom if,

as of the inception of that portion of the trust, the interest will or may reasonably be expected to take effect in possession or enjoyment within 10 years commencing with the date of the transfer of that portion of the trust.

(b) *Exception Where Income Is Payable to Charitable Beneficiaries.*—Subsection (a) shall not apply to the extent that the income of a portion of a trust in which the grantor has a reversionary interest is, under the terms of the trust, irrevocably payable for a period of at least 2 years (commencing with the date of the transfer) to a designated beneficiary, which beneficiary is of a type described in section 170(b)(1)(A) (i), (ii), or (iii).

\* \* \* \* \*

26 U.S.C. 1958 ed., Sec. 673.)

#### SEC. 676. POWER TO REVOKE.

(a) *General Rule.*—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a non-adverse party, or both.

(b) *Power Affecting Beneficial Enjoyment Only After Expiration of 10-Year Period.*—Subsection (a) shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest. But the grantor may be treated as the owner after the expiration of such period unless the power is relinquished.

(26 U.S.C. 1958 ed., Sec. 676.)

## SEC. 683. APPLICABILITY OF PROVISIONS.

(a) *General Rule.*—This part shall apply only to taxable years beginning after December 31, 1953, and ending after the date of the enactment of this title.

\* \* \* \* \*

(26 U.S.C. 1958 ed., Sec. 683.)

Treasury Regulations 118 (1939 Code) :

SEC. 39.22 (a)–21 *Trust income taxable to the grantor as substantial owner thereof—*

\* \* \* \* \*

(c) *Reversionary interest after a relatively short term.* (1) Income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or the income therefrom which will or may reasonably be expected to take effect in possession or enjoyment:

(i) Within 10 years commencing with the date of the transfer, \* \* \*

\* \* \* \* \*





IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

WILL FLITCROFT and AGNES D. FLITCROFT,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

---

REPLY BRIEF FOR PETITIONERS

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ON PETITION  
FOR REVIEW OF DECISION OF  
THE TAX COURT OF THE UNITED STATES

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**FILED**

SEP 12 1960



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OPINION BELOW

The opinion of the Tax Court is reproduced on pages 217 to 247 of the Record.

JURISDICTION

The jurisdictional matters are set forth on pages 1-3 of Petitioners' Opening Brief.



## QUESTIONS PRESENTED

The questions presented are those set forth on pages 12 and 13 of Petitioners' Opening Brief, with the exception that by his new legal theory, hereinafter discussed, respondent concedes that the partnership, Western Hydraulics, was entitled to deduct the rent paid by it from its gross income.

### STATEMENT

The Tax Court found as a fact that during the years 1953 through 1956, Miers was paid a fee of \$60 per day or approximately \$900.00 per month for the services he rendered Western Hydraulics (R. 225-226). Richard H. Miers testified that he averaged more than 40 hours a week in the service of Western Hydraulic (R. 144). Miers further testified that he received the prevailing accounting fee of \$60.00 per day from Western Hydraulic (R. 187). In addition to the fee of \$60.00 per day, the trust agreements (Exhibits 5, 6 and 20 Stip. Facts) did provide in Article VI for a trustee's fee to Miers commencing at 4% of the first \$25,000.00 of the income for each trust (Exhibits 5, 6 and 20).

### SUMMARY OF ARGUMENT

The Tax Court itself has abandoned the position it took in the Flitcroft case by its holding in the case of Mary Kent Miller



(Decided August 14, 1963, Para. 63, 215 P H Memo T.C.) that the decision of a Texas State Court that a trust was irrevocable is binding upon the Tax Court.

The taxability of the income from the Fliteroft trust is to be determined by the rules in effect under the Internal Revenue Code of 1939.

The cases here on review are in essence family partnership cases in which the principal question is that of whether the trustee-partner owned a capital interest in the partnership of Western Hydraulic and Service Company. Petitioners contend that they transferred a capital interest in the partnership to two trusts created for their children and therefore §704(e) of the Internal Revenue Code of 1954 requires that the trusts be recognized as partners. The partner-trusts were created in order to obtain and did in fact obtain and retain the services of Richard H. Miers, the trustee in the petitioners' business, were for the benefit of the grantors within the meaning of §2250 of the California Civil Code, had terms in excess of ten years and were not revocable trusts within the meaning of either §2280 of the California Civil Code or §673(a) of the Internal Revenue Code of 1954 which codified the "Clifford regulations".

A second question, belatedly raised by the respondent, is that of whether rent paid by the partnership to a trust created on October 1, 1953, by the taxpayers constitutes income to the petitioners. The petitioners contend the rent was income to the trusts and not to themselves.





# ARGUMENT

## I

THE TAX COURT ERRONEOUSLY HELD THAT THE INCOME OF THREE TRUSTS CREATED FOR THE BENEFIT OF PETITIONERS' CHILDREN WAS INCLUDABLE IN TAXPAYERS' GROSS INCOME IN THE YEARS 1954, 1955 AND 1956.

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In a Memorandum Opinion rendered in the case of Mary Kent Miller on August 14, 1963, the Tax Court (Para. 63, 215 P. H. Memo T. C. Decision) has corrected the fundamental error it made in the pending case but at the same time sought to distinguish that case from the present "without a difference". It said of Will Flitcroft, 39 T. C. 52 (1962) on appeal (CA-9, March 11, 1963):

"A 1961 California Court judgment reforming the trust instruments and ordering that the trusts were irrevocable from their inception was held to be not binding because it was obtained at the creator's request and was in a limited sense collusive."

The distinction does not exist. It was the trustees and beneficiaries, not the creators who obtained the judgment in the Flitcroft case, (Botsford v. Riddell, CA-9, 283 F. 2d 298, 6 AFTR 2d 6185 Ex. 13). The Tax Court said in its opinion in the Miller case, supra:

"The taxability to petitioner of the income received by the Trustee in 1959 and 1960 depends upon whether she,



as Grantor, had the power to revoke the trust within 10 years from the date it was created. The possibility of the Trust property revesting in petitioner is a matter of State, not Federal, law. Blair v. Commissioner, 300 U.S. 5 (18 AFTR 1132)(1936), Helvering v. Stuart, 317 U.S. 154 (29 AFTR 1209)(1942)

"In this proceeding it must be determined by the laws of the State of Texas.

"Petitioner contends that the trust is irrevocable for a period of 10 years from the date of the transfer to the trust of its corpus and she relies primarily upon the judgment of the State Court as being determinative of the very issue before us. It is true that a matter of State law decided by a court of competent jurisdiction in an adversary proceeding determines the rights of the parties and is, to that extent, binding and conclusive with respect to tax liability. Freuler v. Helvering, 291 U.S. 35 (13 AFTR 834)(1934); Helvering v. Rhodes' Estate, 117 F.2d 509 (26 AFTR 440)(CA-8, 1941), affirming 41 B.T.A. 62 (1940). However, where the State Court judgment is obtained through "collusion" for the purpose of avoiding tax liability, it has no binding effect on the Commissioner. Blair v. Commissioner, supra, Saulsbury v. United States, 199 F.2d 578 (42 AFTR 728)(CA-5, 1952), certiorari denied 345 U.S. 906 (1953). Since the law presumes that court proceedings are regular and valid, we think in a situation like this, where "collusion" is asserted by respondent, it is incumbent upon him to produce at least some evidence to that effect. But here he has not done



so. He merely urges us to find that there was 'no necessity or reason for the State Court judgment except for its effect on the Federal tax question, and all of the parties to the state court action were undoubtedly aware of the position that respondent was going to take'. This alone, in our opinion, is insufficient to give the State Court proceeding a collusive, non-adversary character. Nor was it any less adversary because the statutory notice of deficiency was issued prior to the State Court judgment. Obviously, it was to avoid the possibility of respondent charging that silence is evidence of clandestine collusion that the Government was invited on March 14, 1962, to either intervene or otherwise assist in the State Court action.

"Being unable to find the solution to its dilemma in the conflicting opinions of its counsel and the Internal Revenue Service, and needing the correct answers, the Trustee obtained them from the only source available to it, the District Court of Midland County, Texas. The Trustee was not concerned with income tax liability. It had none whichever way the revocability issue went. It was concerned with real and tangible liability on its part.

"This is not the situation we had before us in Will Flitcroft, 39 T. C. 52 (1962), on appeal (CA-9, March 11, 1963), which is relied on by the respondent. In that case the creator was held taxable on the income of trusts created in 1953 for a term of 10 years and 5 days, where under California law the trusts were revocable until amendments in July 1954 expressly





made them irrevocable. A 1961 California court judgment re-forming the trust instruments and ordering that the trusts were irrevocable from their inception was held to be not binding be-cause it was obtained at the creator's request and was in a limited sense collusive. "

The judgment entered by the District Court of Midland County re-cites that all parties were before the court, represented by independent counsel, the court had jurisdiction, a genuine and justifiable controversy existed and, after hearing arguments of counsel, it concluded that the trust is not "subject to revocation until after the expiration of 10 years from August 7, 1959". This judgment decided an issue regularly sub-mitted and is not in any sense a consent decree pro forma. Following the mandate of the United States Supreme Court in Freuler v. Helver-ing, supra, we are unwilling under these circumstances to "impugn the good faith and judicial character of State Court's decree".

It is submitted that the Tax Court's decision in the pending case should be reversed on the basis of its subsequent decision in the case of Mary Kent Miller, supra, with instruction to hold and determine that trusts A and B, the partnership trusts, were established to have been at all times irrevocable, beyond dispute in the Tax Court, by the judgment of the Superior Court of California (Exhibit 13).

As a matter of California Statutory law the two Flitcroft trusts were also irrevocable because they were created for the benefit of the grantors; by their creation the grantors obtained the valuable service of Richard H. Miers in their business, §2250 California Civil Code. This alone is sufficient to support the Judgment (Exhibit 13)



rendered by the Superior Court of California.

Petitioners still contend as they did in their opening brief that the trust to which the rent was paid was an irrevocable trust and under the rule of the case of Commissioner v. Clark (1953) CA-7, 202 F. 2d 94, 43 AFTR 259, affirming 17 T. C. 1357 that the income of that trust is not taxable to these petitioners, the grantors of the trust. They have never contended that this, the C trust, was a partner in Western Hydraulic and Service Company or that its creation was used as an inducement to bring and hold the badly needed services of Richard H. Miers for petitioners' business.

Title to the business location property and the lease thereon were conveyed to Richard H. Miers as trustee of the joint or C trust by the grantors for the benefit of their two children. Petitioners contend the income of this trust was not taxable to them under the rationale of the case of Commissioner v. Clark (1953) 202 F. 2d 94, 43 AFTR 259, affirming 17 T. C. 1357. This case is fully discussed on pages 29-35 of petitioners' opening brief to which reference is here made.

The respondent's brief cites Reinecke v. Smith, 289 U. S. 172 175 (p. 24 Br. ) for the proposition that the taxability of the income of the 1953 trusts is governed by the provisions of the Internal Revenue Code of 1954.

If the respondent places reliance upon §673(a) of the Internal Revenue Code of 1954, he "leans upon a broken reed". It is inapplicable to the Flitcroft Trusts as they were expressly made irrevocable before the 1954 Code became effective and §7851(a)(2)(B) of the 1954



Code provides:

"(b) Chapter 12 of this title shall apply with respect to the calendar year 1955 and all calendar years thereafter, and with respect to such years chapter 4 of the Internal Revenue Code of 1939 is hereby repealed. '(b) Effect of Repeal of Internal Revenue Code of 1939. -(1) Existing rights and liabilities. - The repeal of any provision of the Internal Revenue Code of 1939 shall not affect any act done or any right accruing or accrued, or any suit or proceeding had or commenced in any civil cause before such repeal, but all rights and liabilities under such code shall continue, and may be enforced in the same manner, as if such repeal had not been made'."

The Clark case, supra, did not go to the Supreme Court; no decision refusing to follow it is to be found.

Congress might have made the provisions of the Internal Revenue Code of 1954 controlling as to rights accrued before its enactment but it expressly refrained from so doing when it enacted §7851(a)(2)(B) of that Code.

Footnote 1 on pages 22 and 23 of respondent's brief discloses that he has abandoned his original and insupportable legal theory, with respect to the joint trust created on October 1, 1953, that rent paid by the partnership, Western Hydraulics, for the use of its business property is not a proper deduction from the partnership gross income. Well he might abandon the legal theory of his





deficiency notice for it is squarely contra the provisions of 23(a)(1) (A) of the Internal Revenue Code of 1939 as well as those found in §162(a)(3) of the Internal Revenue Code of 1954. This original, insupportable, and now abandoned, legal theory of the respondent says has been replaced by a new one. The new legal theory was not heretofore recognized by the petitioners as a legal theory and it is true it was not discussed in their reply brief in the Tax Court nor did they do so in their opening brief in this Court. Not until receipt of the respondent's brief in this Court did petitioners or their counsel realize that the respondent was relying upon a new legal theory. Otherwise no space would have been given the old theory in their brief (See pages 56-59). His concession that the deficiency notices were erroneous places the burden of proof upon him as to the new issue. Lesley Cohen v. Commissioner (1959), CA-9, 265 F.2d 5, 3 AFTR 2d 1157; Eva Rubin v. Commissioner (1963) 63-218 P. H. Memo T. C.

The petitioners find fault with respondent's "new legal theory". First because of some misstatement of fact made to both the Tax Court and to the Appellate Court in support of the theory. The Commissioner's opening brief in the Tax Court is not before this Court as a part of the record on appeal and therefore cannot be intelligently discussed (See Rule 18(e) of CA-9). But accepting the statement from that brief quoted in footnote 1 of respondent's brief in this Court:

"The broad question presented for the court's determination in these consolidated cases is whether partnership income reported by three trusts created by



petitioners (taxpayers) for the benefit of their two children is taxable to petitioners in the years 1954, 1955 and 1956." (Emphasis supplied).

as an accurate quotation the misstatement of fact in the Commissioner's brief before the Tax Court is disclosed. Only two, not three trusts reported any partnership income (R. 56, 57(9), R. 56(3), Exhibits 5 and 6, R. 57(13), Exhibits 17, 18, 19, 20, 26F Schedule K, 27G Schedule K, 28H Schedule K, Pet. Exhibits 37 Schedule A, 38 Schedule A, 39 Item 5, 40 Item 5, 41 Item 5, 42 Item 5, 43 Item 5, 44 Item 5). The third or joint trust reported no income from any partnership but did report income from rent in each of the taxable years here involved (Pet. Exhibits 4 and 5, Item 6, Exhibit 46 Item 6). It is only this trust that is involved in the so-called new legal theory.

A second misstatement of fact is made to this Court in the portion of the footnote found on page 23 of respondent's brief. It reads:

"Thus, instead of disallowing to the partnership the deductions for rent and thereby increasing both its net income and taxpayers' distributive share of this income, the Commissioner allowed the rental deduction to the partnership but included the rental payments to the joint trust in taxpayers' gross income."

The Tax Court's decisions made no adjustments to the taxable income shown in the deficiency notices (R. 248 and 250, R. 253 and 255). The deficiency did not allow any rental deduction to the partnership,



nor did the Tax Court find that the Commissioner had done so. The Tax Court found it to be a fact that: "In each instance respondent gave as an explanation for the disallowance of the claimed deduction for rent that the amount claimed to be paid to the trust for petitioners' minor son and daughter was not a deductible business expense of the partnership." (R. 233). The record here contains nothing to the contrary.

Petitioners accept respondent's abandonment of his contention that the rental payments should be disallowed as a business expense of the partnership. If payment of rent to themselves produces income the respondent's new legal theory has the effect of doubling the income charged to petitioners from the rent.

The Commissioner must plead affirmatively, assume the burden of proof, and, if necessary, claim an increased (deficiency) whenever he asks the Court to take a position inconsistent with that taken in determining the deficiency. Rubin v. Commissioner (1963) para. 63, 218 of Prentice-Hall Memo T. C. Decisions. This the respondent has not done. It is submitted that the record before this Court is insufficient to bring respondent's "new legal theory" before it.

The respondent's brief (p. 28) attacks the judgment of the California Court which reformed the partner-trust agreements as being collusive on two grounds.

First that the taxpayers secured the order of reformation to reduce their federal tax liability. This contention is based on the false premise that the taxpayers secured the order of reformation. There is not a scintilla of evidence in the record to support that





statement. On the contrary the evidence is clear and undisputed that it was the trustees and the beneficiaries of the trusts, not the grantors who are here called taxpayers, who obtained the order of reformation (Exhibits 11, 12, 13 and also Botsford v. Riddell (1960) CA-9, 283 F. 2d 298). The Tax Court has given an adverse answer to a similar contention in the case of Mary Kent Miller, 63-215 P. H. Tax Court Memo Decision.

Secondly that the answer filed by the taxpayers in the Superior Court of the State of California failed to state facts sufficient to constitute a defense to the complaint or any portion thereof (Exhibit 13). Defendants can lose a lawsuit in at least two ways. One, they may not, within the outer limits of truth, be able to state facts in their answer sufficient to constitute a defense to the complaint. Two, they may state facts in their answer sufficient to constitute a defense to the complaint but fail to prove the facts alleged. Honest pleading is to be commended. It conserves the time of courts. It is not an emblem of collusion. Respondent's brief fails to point out any facts that could truthfully have been stated in taxpayers' answer that were not stated therein by them. The Internal Revenue Service was thoroughly aware of the allegations of the trustees' complaint. Botsford v. Riddell, supra. If it had any question about the sufficiency of the defendant's answer, it was free to intervene and file and answer of its own. Rule 24, Federal Rules of Civil Procedure.

In footnote 5 on page 31 of respondent's brief the unique proposition is advanced that the trust agreements (Exhibits 5 and 6) are not "written contracts" and therefore §3399 of the California



Civil Code has no application. The brief cites Gaylord v. Commissioner CA-9, 153 F. 2d 408, 415 as supporting this contention. The trusts in the Gaylord case had no diversity of parties. The grantor and trustee were the same person. The California statutes provide that it is essential to the existence of a contract that there be a plurality of parties. §1550(1) California Civil Code. There was no plurality of parties in the Gaylord case. Reference to the partner-trust agreements (Exhibits 5 and 6) in the present case will disclose that the grantors and trustee were not the same person. Here the Tax Court has found and the evidence shows the transaction not to be shams and that an independent trustee controlled the trust corpus (R. 234). It is submitted that §3399 of California Civil Code applies rather than the holding of Gaylord, supra, for the reason that here there was in fact a plurality of independent parties to the trust agreements. There were written contracts with a diversity of parties (Exhibits 5, 6, R. 234).

Respondent's brief "begs the question" presented in this case when it says (p. 31): "But the reformation cannot occur in such a way as to defeat the already accrued rights of a third party -- in this case the United States." It is submitted that no rights had accrued to the United States if grounds for reformation did otherwise exist. It had no vested right in an error that occurred in a lawyer's office whereby the intention of the parties to a written contract was thwarted and failed to be truly expressed. The lawyer had failed to give the required attention to §2280 of the Civil Code of California when he drew the trust agreements. He admitted and corrected the



error in draftsmanship as soon as it was called to his attention (Exhibits 31-K, 32-L). If the parties created irrevocable trusts on January 1, 1953, and the judgment of the California Court has said they did so, the asserted tax rights of the United States never did accrue as to those trusts. §3399 Civil Code of California.

Respondent's brief cites the case of Title Insurance and Trust Company v. McGraw 72 Cal. App. 2d 290, in support of a contention that no consideration passed to the grantors in the Flitcroft partner-trusts. It is true that in the McGraw case the trial Court found there was no consideration for a deed and gave a judgment rescinding the deed. The judgment was affirmed on appeal. The case is not here in point on the facts. The trial Court of California has found the Flitcroft partner-trusts to be irrevocable from their inception. The trial Court of California found the McGraw trusts to be revocable. The law presumes that Court proceedings are regular and valid.





## CONCLUSION

It is respectfully submitted that the decisions of the Tax Court should be reversed.

Respectfully submitted,

ERNEST R. MORTENSON

EUGENE HARPOLE

By /s/ Ernest R. Mortenson  
ERNEST R. MORTENSON

Attorneys for Petitioners

## CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that in my opinion this brief is in full compliance with those rules.

/s/ Ernest R. Mortenson  
ERNEST R. MORTENSON



No. 18,629

IN THE  
**United States Court of Appeals**  
**For the Ninth Circuit**

DYMO INDUSTRIES, INC.,	}
<i>Plaintiff-Appellant,</i>	
VS.	
TAPEPRINTER, INC.,	
<i>Defendant-Appellee.</i>	

**PLAINTIFF-APPELLANT'S OPENING BRIEF**

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VS.	
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<i>Defendant-Appellee.</i>	}

---

**PLAINTIFF-APPELLANT'S OPENING BRIEF**

---

Plaintiff-appellant files this opening brief in support of its appeal from an order of the District Court denying its motion seeking to enjoin defendant-appellee from using the trademark "TAPEPRINTER" in connection with the commerce of embossing machines.

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**JURISDICTION**

Jurisdiction of the District Court is based upon U.S. Code, Title 28, Section 1338(a) and Section 1338(b), the second cause of action being based upon the trademark laws of the United States and the third cause of action stating a related claim for unfair competition (R. 5, Para. 11; R. 6, Para. 15).

Jurisdiction of this Court is based upon U.S. Code, Title 28, Section 1292(1), this appeal being from an order refusing an injunction (R. 154). The order denying the preliminary injunction was entered on April 5, 1963 (R. 154) and the notice of appeal was filed April 9, 1963 (R. 156) within the 30-day period provided by U.S. Code, Title 28, Section 2107.

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### **STATEMENT OF THE CASE**

Plaintiff's complaint, so far as here pertinent, charges defendant (a) with infringing plaintiff's registered United States trademark "TAPEWRITER" for embossing machines by using a colorable imitation of said mark, to-wit "TAPEPRINTER" in connection with the sale of the same goods (R. 4-5), and (b) with unfair competition by virtue of the same acts, coupled with the adoption by defendant in its machines of certain non-functional features used by plaintiff to identify and distinguish its machine (R. 5-8).

All of the facts pleaded in the complaint are verified (R. 10).

Plaintiff immediately filed a motion for preliminary injunction (R. 20-21). Defendant filed numerous opposition affidavits and exhibits (R. 32-46; 55-59; and 76-152), and plaintiff filed numerous reply affidavits and exhibits (R. 47-54, and 63-75).

On April 5, 1963, the District Court denied plaintiff's motion "finding that there is great doubt as to whether or not the plaintiff has the exclusive right to use the word 'TAPEWRITER' and having denied the motion; and good cause appearing therefor" (R. 155).

This appeal followed (R. 156).

---

#### **SPECIFICATION OF ERRORS**

1. The District Court abused its discretion in the appellate reviewing sense in "finding that there is great doubt as to whether or not the plaintiff has the exclusive right to use the word 'TAPEWRITER' and having denied the motion; and good cause appearing" (R. 155), and in denying the motion for a preliminary injunction for that reason.

2. The District Court abused its discretion in the appellate reviewing sense in failing to enjoin the defendant from using "the notation 'TAPEPRINTER' or any other colorable imitation of the trademark 'TAPEWRITER' in connection with the commerce of embossing machines (R. 29).

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#### **QUESTION ON APPEAL**

May a newcomer in the tape embossing machine market place adopt and use the trademark "TAPE-

PRINTER” in competition with the established and duly registered trademark “TAPEWRITER” as used on the same goods because that newcomer is able to find that several hundred persons have used various permutations of “Tape”; “Printer”; and “Writer” for goods other than tape embossing machines?

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## ARGUMENT

### ARGUMENT ON THE FACTS.

On June 20, 1960, plaintiff adopted the trademark “TAPEWRITER” for embossing machines for embossing plastics, metals and the like (Verified Complaint, Para. 12, R. 5). Registration No. 716,433 on the Principal Register of the United States Patent Office was issued to plaintiff on June 6, 1961 (Verified Complaint, Para. 12, R. 5).

Plaintiff spent large sums of money in advertising and otherwise promoting sales of its embossing tools under the “TAPEWRITER” trademark, particularly on the model “M-5” (Verified Complaint, Para. 19-20, R. 7; Affidavit of Leo B. Helzel, Para. 8, 12, 13, 14 and 15, R. 69-70).

In or about February, 1963 and long after plaintiff commenced the promotion and sale of its “M-5” “TAPEWRITER”, defendant commenced the manufacture, promotion and sale of a competing hand embossing tool under the designation “TAPE-PRINTER” (Verified Complaint, Para. 13, 23, R. 5,



7). The goods of plaintiff and defendant are in direct competition with each other, move through the same channels of trade and in fact are handled simultaneously by the same dealers, distributors or retail outlets (Affidavit of Leo B. Helzel, Para. 10, R. 69).

Simple inspection discloses that "TAPEPRINTER" and "TAPEWRITER" are confusingly similar. The manifest truism that the unauthorized use of "TAPEPRINTER" by defendant is likely to cause confusion or mistake or to deceive purchasers as to the source of such goods or services (R. 5, Para. 13; R. 8, Para. 25) within the prohibition of U.S. Code, Title 15, Section 1114(1) is heightened by two factors. One is that defendant uses the corporate name "TAPEPRINTER, INC." which increases the likelihood of confusion. The other is that the defendant's embossing tool has a number of non-functional, unique and distinctive features in common with plaintiff's tool (R. 7, Para. 7; R. 8, Para. 24).

Defendant has claimed in the affidavit of Benedict E. Bogeaus that it has already expended the sum of \$250,000 and that it has a long term rental obligation amounting to \$100,000. According to the only application of defendant for a permit to issue and sell its stock and the permit resulting therefrom, defendant was only authorized to sell \$25,000 of its capital stock to said Benedict E. Bogeaus. Defendant has just started in business. Under these circumstances, defendant is not in a position to respond in damages and a monetary judgment could not be satisfied (Affidavit of Leo B. Helzel, Para. 16, R. 70-71).



### OUTLINE OF LEGAL ARGUMENT.

The denial of the preliminary injunction turned upon the determination of the District Court that there was great doubt as to whether or not plaintiff has the exclusive right to use the word "TAPEWRITER" (R. 155). This in turn is based upon a showing of a number of third party users of a number of different marks and tradenames in various businesses for various forms of goods. None of these third party users used the same marks or confusingly similar marks for the same class of goods.

In the argument which follows plaintiff recognizes the general rule that an order denying a preliminary injunction will not be reviewed except for abuse of discretion. Plaintiff urges that there is here an abuse of discretion in the legal sense because the District Court disregarded substantive principles of law laid down in *National Lead Company v. Wolfe* (9th Cir. 1955), 223 F.2d 195, as well as the rule of the cases upon which this Court relied in *National Lead*.

As a preliminary to the legal argument, plaintiff points out that its exclusive right to use the trademark "TAPEWRITER" is evidenced by the registration itself. Under U.S. Code, Title 15, Section 1115(a), this registration "shall be prima facie evidence of registrant's exclusive right to use the registered mark in commerce on the goods or services specified in the registration . . .".

Also preliminarily, plaintiff relies upon U.S. Code, Title 15, Section 1116, which grants the District Court "power to grant injunctions, according to the prin-

ciples of equity and upon such terms as the court may deem reasonable, to prevent the violation of any right of the registrant of a mark registered in the Patent Office.”

Under U.S. Code, Title 15, Section 1114(1)(a), a putative infringer is liable to a registrant if he uses “in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive . . .”.

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#### ARGUMENT ON ABUSE OF DISCRETION.

Plaintiff urges that the District Court abused its discretion in denying the preliminary injunction. In so doing, plaintiff does not imply any willful or intentional wrong on the part of the District Court. If such is required to establish abuse of discretion, plaintiff does, as it must, confess error on this appeal—for the District Court granted a full, complete and impartial hearing to the parties on the issues before the Court.

But plaintiff does submit that “The exercise of discretion does not permit the Court to disregard the substantive principles of law established for the protection of litigants.” [*Cohen v. Young* (6th Cir. 1942), 127 F. 2d 721, at page 726].

*Langnes v. Green* (1931), 282 U.S. 531, 541, is to the same effect.

Plaintiff submits that trademark rights are so sensitive to utter destruction if they are not rigorously protected that they should receive especial consideration on a motion for a preliminary injunction. Mr. Justice Holmes, speaking for the Court in *Bourjois & Co. v. Katzel* (1923), 260 U.S. 689, said:

“ . . . It (a trademark) deals with a delicate matter that may be of great value but that easily is destroyed, and therefore should be protected with corresponding care . . . ” (260 U.S. 692).

Similarly, in *Garrett v. T. H. Garrett & Co.* (6th Cir. 1896), 78 Fed. 472, the Court said, page 479:

“ . . . In such a case as this, where the manifest intent was and is to appropriate the good will of the complainants by the fraudulent use of the name ‘Garrett,’ if the complainants be not protected by preliminary injunction against such use,—if, in other words, that question be postponed to the final hearing,—there is every inducement to the defendant to delay and prolong the litigation, continuing, meanwhile, the assaults upon the good will of the complainants, so that, even if final decree be at last rendered in favor of complainants, the good will will have been so seriously and irreparably injured, if not in great measure destroyed, as to leave the complainants practically without remedy. . . . ”

One of the leading and perhaps most objective text writers on this subject, in Callmann, *Unfair Competition and Trade-Marks*, 2nd Edition, Section 88.3, page 1820, has this to say:

“In the unfair competition case, a preliminary or temporary injunction—in most cases issued



*pendente lite* prior to the final hearing on the merits—is of especial importance. All competition is, as noted before, designed to injure the competitor. In the unfair competition case, injury to the plaintiff is not merely an incident of the defendant's act; therefore it is important that the defendant be enjoined as expeditiously as possible if injury to the plaintiff is imminent. When a businessman seeks to injure another, he usually adopts the most effective tactics, and, therefore, the preliminary injunction is essential to the plaintiff's protection. In unfair competition cases, moreover, the defendant aims to hurt the plaintiff by prejudicing him in the public eye; the public is the audience before whom the competitive performance is staged. The greater the publicity accorded to the injurious act, the more aggravated the injury to the plaintiff. Furthermore, the damage to an intangible value will be, in most cases, unascertainable. The extent to which good will has been injured is not susceptible of any easy determination. And the financial responsibility of the defendant is often inversely proportionate to the degree of damage he inflicts. On the other hand, in complicated cases, the final hearing may reveal surprising facts, and the evidence offered will be of decisive importance.

“It is a general rule that the grant of an injunction lies within the court's discretion; this rule is even of greater significance in the unfair competition case.” (Footnote omitted).

Although stated in an entirely different factual complex, the Court, in *Porter v. Jennings* (1891), 89 Cal. 440, laid down broad principles particularly applicable here:

“It must be conceded that if plaintiff prove the allegations of his complaint at the trial, he will be entitled to a judgment of perpetual injunction; but then his judgment is a nullity; the calamity has befallen him; the horse has already been stolen; the sale has already been made; the relief has come too late; the cloud upon his title is an accomplished fact.” (page 444).

\* \* \* \* \*

“To sustain respondents in this appeal would deprive appellant of all benefit which would accrue to him should he finally succeed in his cause, and would be a complete denial of the relief sought by the complaint.” (page 445).

Here plaintiff urges that the denial of injunctive relief at this stage of the litigation is tantamount to the denial of rights granted by the Commissioner of Patents in issuing plaintiff’s registration, and may result in a total destruction of the plaintiff’s rights in the mark.

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#### ARGUMENT ON THE MERITS.

As shown above, the District Court denied the preliminary injunction on the finding that there is great doubt as to whether or not the plaintiff has the exclusive right to use the word “TAPEWRITER” (R. 155). This finding is based upon defendant’s contention that virtually hundreds of persons had used some variation of the words “Tape”; “Writer”; or “Printer” as trademarks and tradenames for a multitude of different goods and businesses (R. 84).

Significantly, *no one* other than plaintiff or defendant used any combination such as "TAPEWRITER" or its conceptual equivalent "TAPEPRINTER" as a mark for tape embossing machines.

As one example of the type of "prior art" upon which defendant relies, it cited "TAPERITER" for dictating machines by Permoflux Corporation (R. 59; 63-65; 73-74; 90-93) and by Grace Electronics, Inc. (R. 57; 90; 104). But these registrations were cancelled on October 30, 1959 (R. 65) and on February 3, 1959 (R. 57, 90), respectively.

Further, the relevant market place is the tape embossing machine field. Yet defendant urged upon the District Court as support for its use of "TAPE-PRINTER" the use of some or all of the syllables used in the competing marks in such far flung markets as dictating machines, pudding dessert powder, rope, watch bracelets, sanitary tampons, candles, automobile mufflers, ad infinitum (R. 115-139).

Plaintiff urges that under controlling rules of law, these third party uses do not impinge upon the rights of plaintiff to enforce its mark against defendant.

The case at bar is analogous to *National Lead Company v. Wolfe* (9th Cir. 1955), 223 F. 2d 195. The District Court, in a decision entitled *Wolfe v. National Lead Co.* (N.D. Cal. 1953), 97 U.S.P.Q. 29, not officially reported, had found that it was not unfair competition for the late comer to use "Dutch Paint" in competition with "Dutch Boy". In that case, the District Court relied heavily upon third party users



of the word "Dutch". Some antedated the use of the word "Dutch" by either of the parties. As to these, the Court said, 97 P.Q. 32:

"32. The historical pattern of the adoption and use of defendant's 'DUTCH BOY' trade mark was established in the face of antecedent descriptive use in the trade of the word 'DUTCH' in reference to white lead; 'OLD DUTCH' for base white (a paint product) by F. O. Pierce & Co., of Long Island, New York; 'DUTCH KAL-SOMINE' for calcimine by The Muralo Company, of New York, New York, and a 1912 listing of a host of 'DUTCH' users in the Trade Mark Directory of the National Paint, Oil & Varnish Association, by which name it was then known."

This Court reversed. Judge Pope, speaking for the Court, pointed out, page 204:

"[8-10] Appellees have attached to their brief in this court a tabulation which was an exhibit in the court below showing uses which third parties, manufacturers or dealers in paint have made of names which include the word 'Dutch'. Substantially the same information was portrayed in a photograph which was also an exhibit and which showed in color paint cans to which were attached labels with trade marks using the word 'Dutch'. A study of the 39 listed uses of the word 'Dutch' reveals that some of them are duplications, some relate to uses discontinued many years ago, some were used but to a limited extent and in single communities or limited localities far from the Pacific Coast to which appellees' operations were confined, and for the most part in the eastern portion of the United States, and some

with respect to which there was no proof of any sale whatever; some relate to non-paint products such as floor wax. The remaining proven third party uses of the word 'Dutch' in connection with paint sale or manufacture are too inconsequential to establish a claim of *publici juris* or the claim that appellant's mark has become a weak mark or to justify on any other theory the acts of these appellees. It may be that some of these third persons may also have been guilty of wrongful infringement, but such would not be a defense or justification for the appellees. It is no excuse for them to say that others have been guilty of the same wrong. *Del Monte Special Food Co. v. California Packing Corp.*, 9 Cir., 34 F. 2d 774; *Potter-Wrightington, Inc., v. Ward Baking Co.*, 1 Cir., 298 F. 398, affirming D.C., 288 F. 597. Uses of the offending word in local areas in the East are no justification for acts of appellees on the Pacific Coast." (Footnotes omitted).

The two cases upon which this Court there relied are most pertinent on the present inquiry. In *Del Monte Special Food Co. v. California Packing Corporation* (9th Cir. 1929), 34 F. 2d 774, the plaintiff used "Del Monte Brand" on various food products and the defendant used it on oleomargarine. With respect to the present defense, the Court said, page 777:

"[3] The appellant relies on the use of the name 'Del Monte' by others upon products sold in grocery stores, such as 'Del Monte flour,' 'Del Monte flake biscuits,' one of a number of varieties of biscuits manufactured by Standard Biscuit Company of San Francisco, 'Del Monte Cream-

ery,' dealing in milk, butter, eggs, and cheese, and 'Del Monte Coffee.' It is sufficient with reference to such use of the name 'Del Monte' upon food products by others to say that, whatever may be the respective rights of the appellee and these other users of the name 'Del Monte,' such use does not justify the appellant in its more recent use of appellee's well-known mark upon a new and different product recently produced by it; for, as has been stated, the question involved here is not the infringement of a trade-mark in which the prior use by others would be material, but is that of the adoption by the appellant of unfair methods of competition. Such practice is unfair to the appellee, notwithstanding the use of the brand by others, even if such use by others preceded the use by appellee. *Natl. Pictures Theatres v. Foundation Film Corp.*, 266 F. 208, 211 (C.C.A. 2); *Liebig, etc., v. Chemists, etc.*, 13 Reports Patent Cases, 635, 645; *Croft v. Day*, 7 Beav. 87; *Juvenile Shoe Co., v. Fed. Trade Comm.* (C.C.A.) 289 F. 57; *Clark Thread Co. v. Armitage* (C.C.A.) 74 F. 936; *Shaver v. Heller & Merz* (C.C.A.) 108 F. 821, 825; *Barton v. Rex Oil Co.* (C.C.A.) 29 F. (2d) 474, 475."

In *Potter-Wrightington v. Ward Baking Co.* (D. Mass. 1923), 288 F. 597, affirmed in *Ward Baking Co. v. Potter-Wrightington* (1st Cir. 1924), 298 F. 398, the defendant in an action to restrain unfair competition and trademark infringement defended in part on the ground that plaintiff's trademark had been in prior use by another. The District Court and the Court of Appeals rejected this defense. The mark in



question was "Old Grist Mill" for flour. With respect to this defense, the Court of Appeals held, 298 Fed. 401:

"[5] 3. The defendant sets up the defense that the plaintiff was anticipated in the use of its trade-mark by one Thornton. It appears that Frank L. Thornton, of Providence, R.I., about 1892, was carrying on a small business as a dealer in corn meal and other cereals; that he adopted a similar emblem (but not the words 'Old Grist Mill'), and that he had it registered as a trade-mark and used it in his business in and near Providence. A bill was brought against this plaintiff to restrain an infringement of Thornton's rights. It was demurred to, and was finally dismissed from the docket. There is nothing in the record tending to show that the plaintiff pirated upon any rights of Thornton. There is no question of invention in a trade-mark case. It may be that it will be found that Thornton, in a limited territory, used a design somewhat similar to that of the plaintiff. Upon this point we think the District Court has properly held that, even if, for some purposes and in some territory, the Thornton Company may have a right in the trade-mark superior to that of the plaintiff, the defendant is not thereby exonerated from responsibility for an attempt to appropriate to itself a good will created by the plaintiff during a long course of business. Whatever Thornton has done or has not done, the ultimate offense is that the defendant has passed off its goods as those of the plaintiff, and has thereby invaded the rights of the plaintiff, rights not acquired by invention or discovery or registration, but by adoption and

use. *United Drug Co. v. Rectanus Co.*, 248 U.S. 90, 103, 39 Sup.Ct. 48, 63 L.Ed. 434, *supra*; *Tetlow v. Tappan* (C.C.) 85 Fed. 774; *Merriam Co. v. Saalfield*, 198 Fed. 369, 372, 117 C.C.A. 245.”

The rule of the foregoing cases is brought down to date in *Fleischmann Distilling Corp. v. Maier Brewing Company* (9th Cir. 1963), 314 F. 2d 149. In that case the unfair competitor tried to justify its use of “Black & White” by showing that the mark lacked novelty. In rejecting this defense, this Court said, page 154:

“It is obvious that in approaching the question which is before us, as to whether the defendants’ use of the name Black & White on their beer is likely to cause confusion or mistake or to deceive purchasers as to the source of origin of such goods, we must recognize that the use of the name Black & White in connection with some wholly unrelated products, goods or services, cannot possibly cause confusion or mistake, or lead customers to believe that the goods or services offered had any connection with Buchanan.

“Thus, defendants produced telephone directories from such cities as Boston, New York, Detroit, Los Angeles, and Pittsburgh, Pennsylvania, showing the use of the name Black & White by numerous firms and businesses. These disclosed Black & White Cleaners and Tailors; Black & White Trucking Company; Black & White Chemical Company; Black & White Dinette; Black & White Hatters; Black & White Garage; Black & White Tire Company; Black & White Market; Black & White Funeral Home, and others. It also appears that there was a small chain of

retail liquor stores in Oakland, California, called Black & White. This was noted in the court's findings, which stated that Buchanan did not know of these liquor stores until after the suit was begun."

Thus plaintiff submits that, as a matter of law, the several hundred "prior uses" which defendant belatedly located in its effort to justify its appropriation of "TAPEPRINTER" in competition with "TAPEWRITER" are immaterial. Plaintiff submits that there has therefore been an abuse of legal discretion in that the determination of the District Court was not based upon controlling legal standards.

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**CONCLUSION**

For the reasons stated above, plaintiff urges that the order of the District Court be reversed and that this cause be remanded with instructions to issue a preliminary injunction enjoining the defendant from using the trademark "TAPEPRINTER" or any other colorable variation of "TAPEWRITER" in connection with the business of manufacturing and selling tape embossing machines.

Dated, San Francisco, California,

June 19, 1963.

Respectfully submitted,  
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**CERTIFICATE OF COUNSEL**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

CARL HOPPE,  
*One of the Attorneys for Plaintiff-Appellant.*

No. 18640

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

OLA BELLE MEREDITH,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

## APPELLEE'S ANSWERING BRIEF.

---

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**APPELLEE'S ANSWERING BRIEF.**

---

**Jurisdiction.**

This Court has jurisdiction to review the judgment of the District Court under Title 28, U. S. C., Section 1291, as this is an appeal from a final order of the District Court for the Southern District of California, granting defendant's (appellee's) motion for summary judgment. The principal contention of the defendant is that the District Court was required to dismiss the action of the plaintiff in the lower court for the reason that said District Court lacked jurisdiction of the subject matter, and of the United States as defendant, by reason of Title 28, U. S. C., Section 2680(k).

**Statement of the Case.**

The plaintiff, Ola Belle Meredith, was the dependent wife of Donald Warren Meredith, who was stationed in and near Bangkok, Thailand, during 1959 and 1960. On about January 15, 1960, the plaintiff was admitted

to the Bangkok Nursing Home, a private hospital in Bangkok, Thailand, under the care of Dr. Chou Chuang Svetarundra, for a Caldwell-Luc operation. At the time of her admission to said hospital, the plaintiff's condition was diagnosed as a chronic sinus condition, requiring more than mere conservative treatment. Dr. Chou Chuang Svetarundra was on a U. S. Embassy approved list of medical specialists, and the plaintiff was referred to Dr. Chou Chuang Svetarundra by Captain Herbert I. Cohen, Captain USAF Medical Corps, assigned at that time to the Medical Unit of the American Embassy in Bangkok, Thailand. A description of the functions of the Medical Unit can be found in the Affidavit of Lewis K. Woodward, Jr., attached as an exhibit to the Government's Second Motion for Summary Judgment filed on November 11, 1962. Please see paragraph 3, first page, Affidavit of Lewis K. Woodward, Jr. In order to enter the right sinus antrum, it was necessary for Dr. Chou Chuang Svetarundra, who was a specialist in eye, ear, nose and throat medicine, to force a hole through the outer wall of the right anterior antrum, in order to clean out and treat the infected sinus area. Dr. Cohen was not "scrubbed" and did not assist in the operation. He merely observed it, as a matter of personal interest. See plaintiff's (appellant's) own Memorandum of Contentions of Fact and Law filed 9-7-62, p. 2 of the letter of Dr. Cohen attached as exhibit.

Although it is not clear exactly when the plaintiff first experienced diplopia (double vision) in the right eye, apparently the plaintiff developed the condition of which she now complains only after the Caldwell-Luc operation.

Prior to going to Dr. Chou Chuang Svetarundra at Government expense, the plaintiff and her husband apparently had some personal interviews with Dr. John Cameron, the Foreign Service doctor at the Medical Unit in the Bangkok Embassy of the United States, and also with Dr. Herbert I. Cohen, with regard to treatment of her condition. The plaintiff claims that she was forced by the doctors at the American Medical Unit to submit to the operation to be performed by Dr. Chou Chuang Svetarundra. Appellee, however, considers the clear and uncontroverted fact to be that the choice of allowing herself to be operated on by Dr. Chou Chuang Svetarundra was made by the plaintiff without duress of any type, and with a full disclosure having been made to her of all of the ramifications of that choice. In any event, this is a question of fact which need not be reached in this appeal, as the claim of the plaintiff would seem to be entirely disposed of by Title 28, United States Code, Section 2680(k). But plaintiff's (appellant's) own memorandum of Contentions of Fact and Law filed 9-7-62 contains as an exhibit a letter from Dr. Cohen indicating the true facts.

The American Medical Unit administered treatment of a "family physician" nature, and was responsible for the care of approximately 3,000 American personnel in and around the American Embassy in Bangkok. Dr. Herbert I. Cohen was the Military Medical Physician attached to the Medical Unit in question. Far from being a specialist of any type, Dr. Cohen was, in fact, in no position to do more for the plaintiff than refer her to a Thai physician for treatment of her condition when it worsened. At no time did the American doc-

tors, Dr. Cameron or Dr. Cohen, represent to the appellant that they were experts in the treatment of sinus conditions. At no time did they represent to the plaintiff that they were qualified to perform operations of any type. At no time did they represent to the appellant that she could not go to Clark Field or anywhere else for treatment, nor did they declare that the plaintiff was barred from going to any doctor of her choosing in the Bangkok area, at Government expense. In fact, how could the Embassy doctors have acted otherwise? And planes left weekly.

It appears that prior to her arriving in Bangkok, Thailand, the plaintiff had experienced chronic sinus conditions in other parts of the world. Please see the statement of Dr. Herbert I. Cohen, attached to the plaintiff's Memorandum of Contentions of Fact and Law, filed September 7, 1962, *supra*.

Plaintiff has never claimed that the diagnoses of Doctors Cohen and Cameron was wrong in any way. That their treatment by them did not consist of a delicate and specialized operation such as a Caldwell-Luc operation would seem to be irrelevant under the facts of the case. The only overt act capable of being recognized at all as a causative factor in injuring the nerve within appellant's sinus which caused the plaintiff's diplopia (apparently) was the operation performed by Dr. Chou Chuang Svetarundra. Obviously, the referral, whether negligent or otherwise, of the plaintiff to Dr. Chou Chuang Svetarundra, and later to Dr. Kobchai by the American medical personnel, would not be actionable under the Tort Claims Act. (Please see Argument, *infra*).



The court below found that 28 U. S. C. §2680(k) barred the plaintiff's recovery in her claim, and that no material issues of fact remained.

### Issues Presented.

1. Title 28, United States Code, Section 2680(k) barred the plaintiff's recovery upon her complaint, and appellee was entitled to judgment as a matter of law.
2. The event or incident which caused the plaintiff's diplopia is not known, but the only overt act which could have possibly caused plaintiff's injury occurred outside of and some distance from the grounds of the United States Embassy in Bangkok, Thailand.
3. Even assuming *arguendo* that some act or event allegedly occurring on the United States Embassy grounds in Bangkok and committed by United States employees, in some way contributed to plaintiff's diplopia, no judicial decision has construed 28 U. S. C. 2680(k) as meaning that "foreign country" does not include a United States Embassy abroad, for purposes of the Tort Claims Act.

## ARGUMENT.

### I.

**Title 28, United States Code, Section 2680(k)  
Barred the Plaintiff's Recovery Upon Her Com-  
plaint, and Appellee Was Entitled to Judgment  
as a Matter of Law.**

Title 28, United States Code, Section 2680(k) pro-  
vides:

“§ 2680. Exceptions

The provisions of this chapter and section  
1346(b) of this title shall not apply to—

(k) Any claim arising in a foreign country.”

The language appears plain enough on its face in Section 2680(k) to preclude any doubt as to its meaning. Congress evidently did not desire to have Tort Claims actions decided on the basis of foreign law, since it is universally conceded that the law of the place where the tort occurred will control substantive claims for personal injury in tort. See *Patrick v. United States*, 316 F. 2d 9 (3d Cir. 1963), citing *Mass. Bonding Company v. United States*, 352 U. S. 128. See also, *Richards v. United States*, 369 U. S. 1, decided October 1961.

The United States has not consented to be sued upon the facts alleged in plaintiff's complaint. See *United States v. Spelar*, 338 U. S. 217. The States of the Union and the Territories over which the United States has the power to enact laws are the only territorial components which Congress intended to include for purposes of consenting to suit under the Tort Claims Act. See *Callas v. United States*, 253 F. 2d 838, cert. den. 357 U. S. 936. The United States clearly makes



no laws as a sovereign respecting the various compounds and buildings located in Bangkok, Thailand, except as permitted by the law of Thailand.

Congress in prescribing the application of the Federal Tort Claims Act with regard to the exception contained in 28 U. S. C. §2680(k) intended that the words “any claim arising in a foreign country . . .” be used in a “common non-technical sense.” See *Juanita Burna v. United States of America*, 240 F. 2d 720 (4th Cir. 1956), which was cited on that point in *Callas v. United States*, *supra*. The *Burna* opinion said,

“ . . . terms like ‘provisional administration’ and ‘residual sovereignty’ invested with ad hoc meanings, may serve usefully to express certain ideas in particular context, but they are, after all, not the precise limits Congress prescribed for the application of the Federal Tort Claims Act. Such terms of special coinage are interesting to examine, and sometimes they may shed light on an inquiry; but we must not be deluded into substituting them for entirely different statutory words which have clear meaning and were apparently used in a common non-technical sense.”

The *Burna* opinion stated that even though in that case the United States “could at any time set aside Japanese laws on Okinawa, the court still could not find that Okinawa was a part of the United States and not a foreign country.” The *Burna* opinion considered that Congress intended to eliminate problems such as the absence of United States courts in foreign countries, the difficulty of bringing defense witnesses from

the scene of the alleged tort in a place far removed to the trial, and reluctance of Congress to have issues of liability decided according to theories foreign to our system of law. The *Burna* case cited the language of Judge Yankwich in *Hichino Uyeno v. Acheson*, District Court, Washington Northern District, 96 F. Supp. 510 at 515. Judge Yankwich said in that opinion,

“It is obvious that the words ‘foreign state’ are not words of art. In using them, the Congress did not have in mind the fine distinction as to sovereignty of occupied and unoccupied countries . . . When the Congress speaks of ‘foreign state’ it means a country which is not the United States or its possessions or colony. . . . The interpretation called for is that of common speech and not that derived from abstract speculation on sovereignty as affected by foreign military occupation.”

On page 4 of the brief of the United States in support of its Motion for Summary Judgment, the following dialogue is set forth, between Congressman Robsion and Francis M. Shay, Assistant Attorney Gen., which appellee now repeats for purposes of emphasis:

*Mr. Shay:* “. . . claims arising in a foreign country have been exempted from this bill . . . This seems desirable because the law of the particular state is being applied. Otherwise it will lead, I think, to a good deal of difficulty.”

*Mr. Robsion:* “. . . you mean by that any representative of the United States who committed a tort in England or some other country could not be reached under this?”

*Mr. Shay:* "That is right—that would have to come to the Committee on Claims in the Congress."  
[1946]

The court in the *Spelar* case, *supra*, granted certiorari (336 U. S. 950) after the Court of Appeals, in the *Spelar* case, reversed the District Court which had dismissed the complaint for want of jurisdiction because the claim was one "arising in a foreign country". The claim occurred in Newfoundland. That air base is leased for ninety-nine years by Great Britain to the United States.

## II.

**The Event or Incident Which Caused the Plaintiff's Diplopia Is Not Known, but the Only Overt Act Asserted by the Plaintiff Which Could Possibly Have Caused Plaintiff's Diplopia Occurred Outside of and Some Distance From the Grounds of the United States Embassy in Bangkok, Thailand.**

The activities by reason of which plaintiff seeks to hold the United States liable consists solely of an alleged incident occurring in a foreign country. As already pointed out, none of the alleged acts occurring in the Embassy grounds are related to plaintiff's alleged injury. Since plaintiff was free at all times to go to any doctor she wished, but availed herself of the free facilities of the Medical Unit for several months instead, at Government expense, it can be inferred from plaintiff's conduct that she was satisfied with the treatment she was receiving from the Medical Unit. Her referral to Dr. Chou Chuang Svetarundra was not due to the fact that she was dissatisfied with the Medical

Staff's treatment of her condition, but was rather due to the fact that the Medical Unit diagnosed her condition as requiring surgery, and recommended that she go to a specialist. The operation performed by Dr. Chou Chuang Svetarundra occurred at the Bangkok Nursing Home, and was performed by Dr. Chou Chuang Svetarundra, assisted by other Thai personnel at the hospital, but no American physicians participated in the operation. Dr. Cohen merely observed the operation so that he could learn how it was done. See memorandum filed by appellant September 7, 1962, exhibit attached thereto, page 2. Dr. Cohen was not "scrubbed" for the operation.

A complaint for negligent misrepresentation (and intentional misrepresentation as well) does not state a claim against the Government under Title 8, U. S. C. § 2680(h). See *Jones v. United States*, 207 F. 2d 563 (2d Cir.); *Natl. Mfg. Co. v. United States*, 210 F. 2d 263 (8th Cir.); *Clark v. United States*, 218 F. 2d 446 (9th Cir.); *Hall v. United States*, 274 F. 2d 69 (10th Cir.); *United States v. Neustadt*, 366 U. S. 696, 81 S. Ct. 1294. See also, *Miller v. United States*, 241 F. 2d 781 (2d Cir.).

The referral by Dr. Cameron or Capt. Cohen of the appellant to Dr. Chou Chuang Svetarundra or Dr. Kobchai, whether negligent or not, is attacked by the appellant as a false representation by the medical staff members to the appellant that Dr. Chou Chuang Svetarundra was qualified to perform the operation under the conditions prevailing in the Bangkok Nursing Home. Even if the referral of the plaintiff to Dr. Chou Chuang Svetarundra had been negligent (which



the United States flatly denies), such claim is not actionable under Section 2680(h).

What acts then, does plaintiff allege to have occurred on the premises of the United States Embassy in Bangkok which caused her diplopia? No measures taken by the Medical Staff at the Embassy were surgical in nature. The drugs administered were mild. But the most significant fact which should here be considered is that the operation performed by Dr. Chou Chuang Svetarundra of Thailand was a completely independent superseding event which broke any chain of causation between plaintiff's injury and any of the acts occurring in the Medical Unit at the United States Embassy. Plaintiff should not be heard to allege that, on the one hand, her diplopia was caused by injury to a nerve occurring during a Caldwell-Luc operation and, on the other hand, that the nerve was injured by any failure of the Medical Staff at the United States Embassy to promptly diagnose her condition as requiring a Caldwell-Luc operation. As already pointed out, appellant does not claim that the diagnosis of Drs. Cohen and Cameron was wrong. Nor did they represent themselves as being eye, ear, nose and throat specialists to appellant. Certainly, appellant cannot claim that anything Dr. Cameron or Dr. Cohen did either increased the seriousness of the chronic sinus condition or caused plaintiff's diplopia. The record reveals nothing to support such a claim. Nor does the record show that anything that could have been done at Clark Field in the Philippine Islands could have prevented the diplopia from occurring, even if the Caldwell-Luc operation had been performed in the Philippines rather than in Thailand.

Moreover, plaintiff need not have abided by the list of physicians recommended by the Medical Unit Staff at the United States Embassy in Bangkok. Please see paragraph 3, first page of the Affidavit of Dr. Lewis K. Woodward, Jr., an exhibit attached to the Government's Second Motion for Summary Judgment, filed November 11, 1962. See also on this point, the Affidavit of Dr. Chou Chuang Svetarundra, also attached as an exhibit to the Government's Second Motion for Summary Judgment, filed November 11, 1962.

The first diagnosis of diplopia was made by Dr. Kobchai Prommindaraj, Professor of Ophthalmology at Chulalongkorn Medical School, Thailand, who diagnosed the plaintiff's condition as diplopia after the Caldwell-Luc operation. Dr. Thomas Tredici, at Clark Field, Philippine Islands, an employee of the United States, diagnosed the plaintiff in complete accord with the diagnosis of Dr. Kobchai. The harm occurring to the plaintiff was the result of some damage to an eye nerve. The plaintiff never experienced any diplopia until after the Caldwell-Luc operation. Dr. Kobchai and Dr. Tredici would not commit themselves that the nerve was damaged as a result of the Caldwell-Luc operation. They said that such had never yet been the result of a Caldwell-Luc operation, in their experience. But giving the plaintiff the benefit of the doubt, and assuming *arguendo* only that the Caldwell-Luc operation caused the nerve injury, no part of said operation took place on the United States Embassy premises, and no part of said operation was performed or supervised by United States Government personnel. The record is clear and unequivocal on this point.



If plaintiff is claiming that the failure of Drs. Cohen and Cameron to diagnose her condition as being one requiring surgery was negligence, what law would then apply with regard to the standard of care required? Obviously, the law of Thailand would control. Appellee therefore contends that Section 2680(k) would bar the plaintiff's claim.

The record indicates that the plaintiff never complained of nor noticed diplopia until after the Caldwell-Luc operation. And plaintiff has never claimed that a sinus condition alone could have caused her diplopia. But even if plaintiff had claimed that the serious, chronic sinus condition experienced by her could have caused her diplopia, the United States cannot be held responsible for having caused such sinus condition, as it pre-existed the plaintiff's arrival in Thailand.

All of the aforementioned facts and contentions of fact are simply pointed out for the purpose of showing that no act or event having a causal relationship to the appellant's diplopia actually occurred on the grounds of the United States Embassy in Bangkok, Thailand. Although the plaintiff obviously could not get along in the climate of Bangkok, Thailand, and her chronic sinus condition was steadily worsening, she chose to remain in Thailand; certainly she cannot contend that she would have been denied a request for return passage to the United States.

Plaintiff says, on page 10 of her brief, that sovereignty is a principle not based on acts of Congress. The Tort Claims Act is, however, based entirely on enactments of Congress, as evidenced by 28 U. S. C. § 2680(k) and 28 U. S. C. A. § 2680(h), as well.

III.

Even Assuming Arguendo That Some Act or Event Allegedly Occurring on the United States Embassy Grounds in Bangkok, and Committed by United States Employees, in Some Way Contributed to Plaintiff's Diplopia, No Judicial Decision Has Construed 28 U. S. C. §2680(k) as Meaning That "Foreign Country" Does Not Include a United States Embassy Abroad, for Purposes of the Tort Claims Act.

In addition to the citations already presented above, appellee wishes to point out the case of *Acheson v. Kuniyuki*, 189 F. 2d 741 (9th Cir.), in which the Ninth Circuit Court of Appeals quoted statements made by Judge Yankwich in the case of *Uyeno v. Acheson*, D.C. Wash. 25, 96 F. Supp. 510, *supra*.

The appellant has designated, as part of the record on appeal, the deposition of Dr. Herbert I. Cohen, filed on September 10, 1962. But if either the United States or the appellant desired to take the depositions of other parties involved, such as Dr. Chou or Dr. Kobchai, or Dr. Tredici, or even Dr. Cameron, the chances are excellent that those persons would be found in faraway countries, requiring that counsel for the United States travel many thousands of miles under uncertain conditions in order to participate in the taking of such depositions. In addition, the nurse who assisted Dr. Chou Chuang Svetarundra in the operation would be a person whose deposition would presumably have to be taken, and she still resides in Bangkok, Thailand. Language problems would present themselves both in the questioning of witnesses in Thailand, and in presenting to the trial court the laws of

Thailand relating to negligence of physicians. Thus, the purpose of Section 2680(k) is obvious.

Nevertheless, appellee respectfully represents to this Court that the Government of the United States has done everything possible, through the furnishing of free medical care to the plaintiff, in an attempt to bring about a cure of plaintiff's condition. No doubt, plaintiff will be entitled to free medical care for many years to come, for every attempt will be made by Government medical physicians to restore her proper vision. While no monetary value can be placed on these free services, it cannot be said that the plaintiff has been entirely without a remedy for her injury. A private bill, submitted to Congress, might furnish her with some additional monetary remedy, although counsel for the appellee naturally cannot represent to this Court that such private legislation could be successfully pursued by the plaintiff.

As part of the military mission of the United States in Thailand, the plaintiff's husband was serving his country in the Armed Forces in a fashion which *per se* involved some danger to himself. Appellant accompanied her husband to Thailand and was herself exposed to the same hazards. The Congressional mandate set forth in Title 28 U. S. C. § 2680(k), must be interpreted as precluding her recovery of monetary damages for her injury, under the circumstances.

Compare Title 10, U. S. C. A., Section 2734.

### Conclusion.

No material issues exist which might effect the application of Title 28 U. S. C. 2680(k) in the case at bar. The undisputed facts show a series of events occurring in Bangkok, Thailand, culminating in appellant's present condition of double vision in her right eye. Appellant's own memorandum, filed September 7, 1962, asserts that Dr. Cohen did no more than observe the Caldwell-Luc operation, and that appellant decided on her own to submit to said operation by Dr. Chou, a Thai physician specializing in ear, eye, nose and throat practice. Appellant at no time indicated by her conduct that she was dissatisfied with treatment rendered at the United States Medical Clinic in Bangkok. Her worsened sinus condition was neither caused nor added to by the Government doctors in Bangkok. The Medical Unit at the Embassy was not staffed or equipped to do more for appellant than it did. Appellant could have returned to the continental United States but chose to remain with her husband in Thailand, despite her serious sinus condition. The Medical Unit in Bangkok referred appellant to a specialist whose reputation is unassailed. Appellant contends these facts do not constitute valid reason for circumventing the clear language in Section 2680(k).

Respectfully submitted,

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### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GORDON P. LEVY





No. 18,629

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

DYMO INDUSTRIES, INC.,

*Plaintiff-Appellant,*

*vs.*

TAPEPRINTER, INC.,

*Defendant-Appellee.*

---

## BRIEF FOR APPELLEE.

---

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No. 18,629

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

DYMO INDUSTRIES, INC.,

*Plaintiff-Appellant,*

*vs.*

TAPEPRINTER, INC.,

*Defendant-Appellee.*

---

## BRIEF FOR APPELLEE.

---

### Statement of the Case.

The Defendant-Appellee respectfully submits this, the Appellee's Brief, in answer to Plaintiff-Appellant's Opening Brief.

The appeal herein is from an Order of the District Court denying appellant's motion for a *Preliminary Injunction* for alleged trademark infringement.

(All italics in this brief will be supplied unless otherwise indicated).

### The Facts.

Appellant claims that appellee's corporate trade-name "Tapeprinter, Inc." and appellee's mark, "TapePrinter", infringe appellant's purported trademark, "TAPE-WRITER", both used in connection with embossing machines to "write" or "print" on "tape". Its claim of unfair competition depends fundamentally on the alleged infringement.

Appellee contests validity of appellant's trademark, upon the grounds that: appellant has failed to establish title or ownership of the trademark in question, third parties having acquired prior rights to the mark; that appellant's *primary* trademark is DYMO and that the word TAPEWRITER is used in conjunction with and as descriptive of the DYMO product; that the mark TAPEWRITER is generically descriptive and cannot be exclusively appropriated; that, in any event, the marks are dissimilar and not likely to cause confusion as to *origin* of the product; and that, in addition, appellant's unclean hands, misuse, laches and estoppel, bar any relief. The issue of secondary meaning is not involved, not having been alleged, claimed or proved. The appellant, however, attempts to raise the question for the first time on appeal.

Appellee contends that the marks involved herein, when considered in their entirety, are phonetically and visually distinct. Nor are the color schemes, designs and inscriptions of the respective marks sufficiently similar to cause confusion. There is no suggestion in the record that any confusion has arisen during the period of concurrent use.

It is significant that appellant uses its corporate name DYMO as its *primary* trademark, in conjunction with and displayed more prominently than the descriptive mark TAPEWRITER, thus constituting an additional distinction. [Exs. A-F, pp. 11-16.] Of added significance is the Registration symbol appearing after the mark DYMO without its appearance after the mark TAPEWRITER [Ex. D. Tr. p. 14], notwithstanding registration of the TAPEWRITER mark and the mere pendency of application for registration of the DYMO mark in said classification. [Ex. E, Tr. p. 141.]

The Record shows at least 574 third-party registrations and Common Law marks which include either the term "tape" or the word "write" or its phonetic equivalent "rite", or "printer", for goods stated to be in various phases of the tape field, and in other fields for a variety of products, some of them in the same classification. [Exs. A through D, Tr. pp. 90-140.] Included in the Exhibits are a number of Affidavits of third party registrants attesting to such prior adoption and use. [Tr. pp. 93-104.] Appellant's registration of the mark TAPEWRITER was subsequent to third parties' prior registrations and/or common law prior rights in trademarks and trade-names under the respective names of TAPE-RITER, TAPERITE, TAPE-RITE COMPANY, TAPE-RITE CO., TAP-RITE, TAPRINT, INDUSTRIAL TAPE PRINTERS, YORK TAPE PRINTERS, INC., and other similar names. [Tr. pp. 90-91.]

Appellant, in its "Argument on the Merits", refers to the cancellation of the TAPE-RITE third party registration of Permoflux, but fails to mention that the State Registration was cancelled because of the registrant's removal from that State and that its affidavit in the Record attests to its continued use as a common-law trademark. [Ex. A, Tr. p. 93.] Nor does appellant refer to the other proofs in the record of the prior adoption and continued use by other of the third party owners of common law marks.

Many issues, apart from confusion, are involved in this case, which cannot be properly beyond dispute on the affidavits and pleadings at this stage of the proceeding. These include not only the question of appellant's right to the trademark but also the defenses of

unclean hands, misuse, laches, acquiescence, estoppel, monopoly, and other issues of fact in the Record.

The record has not disclosed any predatory conduct on the part of the appellee. It has not been shown that appellee cannot respond in damages, or that appellant does not have an adequate remedy other than by preliminary injunction. Although appellant claims irreparable injury, no showing has been made beyond conclusory statements in its affidavits. There is no factual statement of any loss of sales. Nor is there one word in the record as to the effect of the supposed similarity of the products upon the market. To the contrary, appellant's business has increased, notwithstanding its claims of alleged infringement and unfair competition.

A preliminary injunction herein would be equivalent to a final decree for the appellant. The appellee would be subjected to great and irreparable injury were a preliminary injunction to issue herein.

The District Court's denial of preliminary injunction herein was based on the finding of fact "that there is *great doubt* as to whether or not the plaintiff has the exclusive right to use the word TAPEWRITER".

### Questions Presented.

1. Whether a preliminary injunction may issue where the Court finds that "there is *great doubt* as to whether or not the plaintiff has the exclusive right to use the word TAPEWRITER".

2. Whether injunctive relief may be granted where appellant has failed to establish ownership of the trademark in question.



3. Whether registration can confer title to a trade mark where third parties acquired prior rights by earlier adoption, use and registration.

4. Whether the mark in question is merely descriptive of a primary mark where appellant's corporate name DYMO is used in conjunction with the mark TAPEWRITER and the registration symbol appears after the primary mark DYMO.

5. Whether appellant's use of the registration symbol after the mark DYMO prior to such registration bars relief.

6. Whether, in any event, the mark TAPEWRITER, composed of two common words of the English language, describing the function of the product, is generically descriptive and incapable of exclusive appropriation.

7. Whether, in any event, the marks, being dissimilar phonetically and visually, are likely to cause confusion as to *origin* of the product.

8. Whether, in any event, numerous third-party registrations of the mark are indicative of unlikelihood of confusing similarity.

9. Whether appellant is entitled to injunctive relief pending trial without any showing in the Record of irreparable damage to plaintiff or of defendant's inability to respond in damages, and where a preliminary injunction would be equivalent to a final decree for the appellant, to the irreparable injury of appellee.

10. Whether appellant is barred by unclean hands, misuse, laches and estoppel, from any relief.

11. Whether the District Court's findings of fact, supported by the Record, can be disturbed on appeal.

### Appellee's Contentions.

1. The District Court properly denied a preliminary injunction based upon the finding "that there is great doubt as to whether or not the plaintiff has the exclusive right to use the word TAPEWRITER".

2. The authorities relied upon by appellee herein, furnish persuasive reason for affirming the Order denying injunctive relief.

3. The cases relied upon by appellant as authorities, are distinguishable and inapplicable.

4. The latest decision in the Ninth Circuit on the subject of the issues herein was decided in favor of defendant. The case at bar is *a fortiori*.

5. Appellee contests validity of appellant's trademark. The burden is on appellant to prove its ownership of the mark to establish infringement.

6. Appellant has failed to sustain such burden of proof and has not established title to the mark.

7. Third Parties acquired prior rights to the mark which bars any relief to appellant.

8. Registration cannot confer title to a trademark where a third party has acquired a prior right by adoption and use.

9. In any event, third party registrations are elements to be considered in passing on any question of likelihood of confusion.

10. The fact that any of the registrations have expired or have been cancelled does not negate their evidentiary value as showing weakness of term as part of the mark.

11. Third party registrations have weight in showing that the prefix or suffix of a mark is either descriptive or suggestive.

12. The greater the number of similar third party marks, already in use, the less likelihood that their products will be associated or attributed to one source.

13. The 570 marks comprising the term “tape” or “write” are far more than the number of third party registrations considered in many court decisions as determinative of unlikelihood of confusion.

14. It has always been the rule that any such generically descriptive term (as “tape” and “write”) may not be exclusively appropriated as a trademark, in any event.

15. It is obvious that appellant’s TAPEWRITER mark is “weak” as an indicator of *source* or *origin* of the goods.

16. The law does not recognize a monopoly of the English language. Appellant has no exclusive right to the use of the mark.

17. Appellant has not, for purposes of this motion at least, clearly established its right to exclusive use of the trademark in question.

18. Nor is there any question of secondary meaning involved in this case.

19. The marks involved herein, when considered in their entirety, are phonetically and visually distinct.

20. Appellant’s mark, DYMO, coupled with its mark TAPEWRITER, constitutes an additional distinction.

21. The more prominent display of the DYMO mark makes DYMO the *primary* trademark coupled

with the TAPEWRITER mark as descriptive of the product.

22. The mark, TAPEWRITER, obviously describes the function of the product.

23. The best evidence of likelihood of confusion is actual confusion. No instance of confusion has been presented. Mere "possibility" is not enough.

24. Any doubts created by appellant's record must be resolved against it. It must be presumed that plaintiff made the strongest showing possible.

25. The moving papers do not establish that a denial of preliminary injunction will cause irreparable damage to plaintiff's pending action. No showing has been made beyond conclusory statements in its affidavits. There is no factual statement of any loss of sales or of the effect of the supposed similarity upon the market. To the contrary, plaintiff's business has increased, notwithstanding its claim of unfair competition.

26. It has not been shown that defendant cannot respond in damages, or that plaintiff does not have an adequate remedy other than by preliminary injunction.

27. It is a cardinal principle of equity jurisdiction that a preliminary injunction shall not issue in a doubtful case.

28. A preliminary injunction herein would be the equivalent to a final decree for the plaintiff.

29. The general purpose of a preliminary injunction is to maintain the *status quo*, and not to require the defendant to make such changes in its business



that, in the event it should succeed on final hearing, the injury caused to it by the preliminary injunction would be irremediable.

30. It is axiomatic that a stronger case must be presented by a party seeking a preliminary injunction in advance of trial than for similar relief after trial.

31. Defendant is entitled to have all the facts and circumstances as to the use of the mark, the purposes and intents of the parties, and the probable effect of continued use of the mark, presented to the Court at a trial before the Court can properly determine such issues.

32. Many issues, apart from confusion, are involved in this case, which cannot be properly beyond dispute, on the affidavits and pleadings at this stage of the proceeding. These include not only the question of plaintiff's right to the trademark but also the defenses of unclean hands, laches, acquiescence, estoppel, monopoly, misuse, and other issues of fact.

33. It is well established that the issues of laches, acquiescence or estoppel bar injunctive relief.

34. It has consistently been held that the issue of unclean hands bars a preliminary injunction; that the defendant is entitled to present the issue on evidence at a trial.

35. Plaintiff's misrepresentation of the registered symbol on its DYMO mark used in conjunction with its TAPEWRITER mark, and the threats made by plaintiff against defendant, estop the plaintiff, and its "unclean hands" bar injunctive relief at least preliminarily.



36. The plaintiff, under the guise of unfair competition, is attempting to create a perpetual monopoly. Economic competition rather than monopoly should be encouraged.

37. The District Court's finding herein is not "clearly erroneous", but, to the contrary, is clearly supported by the Record and by law and reason.

38. It is, therefore, respectfully submitted, that the Order appealed from, be affirmed.

## POINTS AND AUTHORITIES.

### POINT I.

#### A Preliminary Injunction Cannot Issue in a Doubtful Case. Findings of Fact Supported by the Record May Not Be Disturbed on Appeal.

The District Court, in determining the issues of fact herein, made the finding “that there is *great* doubt as to whether or not the plaintiff has the exclusive right to use the word “TAPEWRITER”.

Such finding of fact may not be disturbed on appeal.

The Courts have uniformly held that, where doubt exists, an injunction shall not issue.

The Supreme Court of the United States long ago admonished, in *Trudy v. Wanser*, 5 How. (46 U. S.) 140 (1847), at page 142:

“There is no power, the exercise of which is more delicate which requires greater caution, deliberation, and sound discretion or more dangerous in a doubtful case, than the issuing an injunction”.

This Court, in the recent case of *Coast Metals Inc. v. Wall Colmonay Corporation* (9th Cir., No. 18,173 March 27, 1963), at page 4, restated the rule, that:

“The findings of the Trial Court will not be disturbed unless *clearly* erroneous. (Citing authorities).”

This Court has held, in affirming denial of an injunction in an action for trademark infringement, that “essentially, the question is one of fact”. (*Miles Laboratories, Inc. v. Frolich*, 132 U. S. P. Q. 122 (9th Cir., Dec. 1961) (affirming 130 U. S. P. Q. 18).)

The Supreme Court of California has held, to the same effect, "it is a question of fact to be determined from all circumstances of the case". (*Schwartz v. Slenderella Systems of California, Inc.*, 102 USPQ 177 (1954).)

The pronouncements of courts in other Circuits, equally apply here. The Chief Justice of the Second Circuit Court, in *Huber Baking Co. v. Stroehmann Bros. Co.*, 208 F. 2d 464 (1953), in affirming the denial of a preliminary injunction, pointed out, at page 467:

"Indeed, so much is left *doubtful* on the record here made that the denial of a preliminary injunction was well within the bounds of *sound discretion*. (Citing authorities)."

The authorities are all to the same effect, as pointed out in the recent trademark infringement case of *Interlego A.G. v. Leslie-Henry Co. Inc.*, 136 USPQ 601 (Feb. 1963), at page 602, on denial of a motion for preliminary injunction:

"A preliminary injunction should be granted only in a clear case. The court must be satisfied that it is necessary to prevent irreparable injury during the pendency of the action. The party seeking the injunction must show at least a reasonable probability of success in the principal action. The court should balance the inconveniences and injuries which will be caused by the grant or denial of the injunction. *Warner Bros. Pictures Inc. et al. v. Gittone*, 3 Cir. 1940, 110 F. 2d 292; *Joseph Bancroft & Sons Co. v. Shelley Knitting Mills, Inc.*, 3 Cir., 1959, 268 F. 2d 569,

122 USPQ 113; *Speeddry Products Inc. v. Dri Mark Products Inc.*, 2 Cir. 1959, 271 F. 2d 646, 123 USPQ 368.”

The “balance of convenience” was stated by *Callman* in *Volume 4* of his text on *Unfair Competition and Trademarks*, at page 1826, as follows:

“In balancing the equities the following considerations are pertinent. On the part of the plaintiff: A *clear* case must be established with respect to the right of, and injury to, the plaintiff; if there is substantial *doubt* on either point, the preliminary injunction should be *denied*. This may, of course, be a question of fact. That is, it may be open to doubt whether the plaintiff’s mark had acquired a secondary meaning, whether the plaintiff was himself chargeable with laches, or whether he had abandoned his right. If a question cannot be decided except upon the presentation of voluminous evidence, or if the facts asserted by plaintiff are controverted under oath, a preliminary injunction will not be granted.”

*Callman* additionally pointed out, at page 1830:

“A preliminary injunction is not a precautionary remedy. The damage must be imminent. The plaintiff’s own conduct, for instance, when the defendant asserts that he seeks equity with unclean hands, may bar a preliminary injunction. If the defendant would be subjected to great and irreparable injury because of the issuance of a preliminary injunction, such relief will be denied.”

This is particularly true in the case at bar.

It is well settled that a stronger *prima facie* case must be presented by plaintiff seeking a *preliminary* injunction against unfair competition than when seeking similar relief after trial.

This Court has repeatedly held that “It is so well settled as not to require citation of authority” that the usual function of a preliminary injunction is to preserve the *status quo* pending a determination of the action on the merits and is not to grant the moving party the full relief to which it might be entitled at the conclusion of a trial.

The case at bar is *a fortiori*.

## POINT II.

**Registration in Itself Does Not Create a Trademark nor Is It Determinative of Its Validity. Appellant Cannot Restrain Use of a Mark to Which Registration Appellant Was Not Entitled.**

This Court, in the recent case of *Pacific Supply Cooperative v. Farmers Union Central Exchange Incorporated et al.* (9th Cir., No. 17,967, June 3, 1963), restated the rule, at page 20, that:

“Trademark Rights are not dependent on statutory enactment, but arise under common law from prior exclusive appropriation or adoption and use. (Citing authority).”

The authorities are all in harmony, to the same effect. As was pointed out, in *The W. E. Long Co. Independent Bakers' Cooperative v. Burdett*, 134 USPQ 147 (June 1962), by the West Virginia Supreme Court of Appeals, at page 151:

“*The law is well settled by the decisions of appellate courts in many jurisdictions that federal*



and state statutes do not create a trademark; (citing authority). \* \* \* *Registration cannot confer a title to a trademark, if some other person has acquired a prior right by adoption and use; nor can it vest a title in the registrant as against the common law title of another person. Coca-Cola Company v. Stevenson, 276 F. 1010; Carroll & Son Company v. McIlvaine & Baldwin, Inc., 171 F. 125.* \* \* \* The mere registration of a trademark does not of itself confer any greater rights than existed at common law without registration but *only procedural* advantages and does not enlarge the substantive rights of the registrant. (Citing authorities.) \* \* \* In the opinion in *United States Ozone Company v. United States Ozone Company of America*, 62 F. 2d 1019, 66 USPQ 232, 238, are these statements: "Registration of a trademark \* \* \* in itself gives no property right in the mark. (Citing authorities). *Nor is such registration controlling in a suit involving the common-law rights to the registered mark or in a suit for unfair competition involving its use. B. F. Goodrich Co. v. Kenilworth Mfg. Co., Cust. & Pat. App., 40 F. 2d 121, 5 USPQ 76; Postum Cereal Co. v. California Fig Nut Co., 272 U. S. 693, 47 S. Ct. 284, 71 L. Ed. 478.*"

As was expressed in the recent case of *General Controls Co. v. Hi-G, Inc.*, 136 USPQ 570 (Dec. 1962), at page 575:

"There is little force in the *mechanical argument* that merely because 'hi-g' was accepted for registration, the plaintiff may preclude all others from making any use of that mark in commerce. (Citing authorities)."

And, as expressed by the Chief Justice of the Court of Appeals for the District of Columbia, in *Robertson v. United States*, 287 Fed. 942, at page 945:

“The owner of a trademark could secure nothing which he did not have before, except a presumption which might be overturned by proof.”

As stated by the Second Circuit Court of Appeals, in *Spiegel v. Zuckerman*, at page 64:

“Such *prima facie* proof may be overcome, if it be made to appear that the applicant was not entitled to the particular trademark which he sought to appropriate.”

The Appellant's trademark, in question herein, is not incontestible. Appellee contests its validity on each of the grounds set forth in the separate Points, *infra*.

### POINT III.

#### **Appellant Who Is Infringing an Earlier Trademark of a Third Person Cannot Maintain Any Action Against Appellee Founded on Infringement of Trademark in Which Appellant Has No Ownership or Property Rights.**

It is axiomatic that appellant must prove its ownership of the trademark to establish infringement.

The appellant herein cannot establish title to the mark, since third parties acquired prior rights thereto. Appellant's registration of the mark TAPEWRITER was subsequent to third parties' prior registrations and/or common law prior rights in trade-marks and trade-names of the same or substantially same name.

The Supreme Court of the United States held, in the early case of *Ubeda v. Zialcita*, 226 U. S. 452,

57 L. Ed. 296, 33 S. Ct. 165, that any action founded upon the infringement of trademark, where the complaining party is itself guilty of infringing an earlier mark of a third person, must be defeated in such infringement suit, even where the owner of the earlier trademark may have had no registered title.

Mr. Justice Holmes, who delivered the Opinion of the Court, pointed out, at page 452:

“It was a matter to which he (the defendant) could refer when the *plaintiff sought to exclude him from doing just what the plaintiff had done himself*”.

Mr. Justice Holmes denounced such conduct as “unclean hands” which debarred plaintiff from maintaining suit, and declared:

*“Imposition on the public is not a ground on which the plaintiff can come into court, but it is a very good ground for keeping him out of it.”*

The case has been much cited for its holding that, one, whose registered trademark is an imitation of an earlier though unregistered trademark, cannot restrain a third party from using it.

In following this decision, the Court, in *Prichard & Constance v. Aime Co.*, 5 Fed. Supp. 282, denying injunctive relief, pointed out, at pages 283-284:

“Plaintiff has by its actions shown what it believed as to the lack of similarity of the words AMAMI and AIMEE when it registered its trademark; the trademark AIMEE being then registered.

“Actions speak louder than words. \* \* \*

“But I must and do assume that plaintiff’s officers did not consider its name AMAMI so similar to the Hudnut trademark as to infringe.

\* \* \*

“If the word AMAMI is imitated by the user of the word AIME, then it would seem to me that the word AMAMI was an imitation of the word AIMEE, and that, if plaintiff’s trademark was an imitation of Hudnut’s, an *earlier* registered one, *plaintiff cannot restrain the defendant from using it. Ubeda v. Zialcita*, 226 U. S. 452, 33 S. Ct. 165, 57 L. Ed. 296.”

Similarly, in the case at bar, “plaintiff has by its actions shown what it believed as to the lack of similarity of the words” TAPEWRITER and TapePrinter when appellant registered its trademark TAPEWRITER; the mark TAPEPRINTER and its phonetic equivalent TAPRINT being then registered and in common law use by others, when plaintiff registered its mark TAPEWRITER.

The case at bar is *a fortiori*. The word TAPEWRITER and its phonetic equivalent, TAPERITER and similar words, TAPERITE and TAP-RITE, had been previously registered by others, and in common law use, when Appellant registered its mark TAPEWRITER.

The Courts have uniformly barred relief under such circumstances.



In the more recent case of *O'Connor & Gordon, Inc. v. By-Line Publications, Inc.*, 104 USPQ 130 (N. Y. S. Ct.) (1955), it was stated, at page 132:

*"The mere fact that there is at least one magazine using the name "QUICK" in addition to the plaintiff is sufficient to defeat the plaintiffs in this litigation. The use of the name must be exclusive and registration in itself does not create a trade mark nor is it essential to its validity. (Rockowitz Corset & Brassier Corp. v. Madame X Co. Inc., 248 N. Y. 272.)"*

It was similarly held, in *Neuhoff Brothers v. Oscar Meyer Packing Company, Inc.*, 98 USPQ 195 (1953 D.Ct. N.D. Tex.), that one may not, by common law right or trade mark registration, claim right in a mark previously claimed and used by others. The Chief Judge there pointed out, at page 195:

*"There has been a continued use of this word, and, of these words, on various, and, sundry pork sausage outputs throughout the nation for a number of years prior to the securing of the trademark in Texas by the plaintiffs. Plaintiff may not by a common-law right, or, even by a copyright, claim that which has already been claimed and used by others. \* \* \**

*"I think the law should keep its hands off here."*

In the recent case of *Younker v. Nationwide Mutual Insurance Co.*, 137 USPQ 901 (June 1962), the Ohio Supreme Court declared, at pages 904-905:

*"Such rights belong to the one who first actually adopts and uses the name or mark in connection with his business. (Citing authorities)."*



In an earlier case, *Benjamin Moore & Co. v. Auwell*, 178 Fed. 543, the Second Circuit Court of Appeals held, at page 544:

“Although the word MURESCO is itself sufficiently fanciful and nondescriptive to be a good trademark, *it was not open to the complainant when adopted* \* \* \*. Prior to that time \* \* \* there was on sale in this country an English-made wall covering of somewhat similar character, which was known to the trade under the name DURESCO \* \* \*. *With this latter word already appropriated to such goods as a legitimate trademark, no one could, by merely changing its first letter from D to M, acquire any right to insist that the slightly modified word should be recognized as the trademark of his own goods.* *O’Rourke v. Central City Soap Co.* (CC) 26 Fed. 576.”

Similarly, in the case at bar, the plaintiff cannot, “by merely changing its first letter” by adding the letter “w” to the word “rite”, “acquire any right to insist that the slightly modified word should be recognized as the trademark of his goods”, since third parties had prior thereto adopted the trade marks and trade names TAPEWRITER and TAPERITE and the other similar prior registered and common law marks. To paraphrase the Second Circuit Court, “it was not open” to plaintiffs when it adopted the mark TAPEWRITER in 1960.

In *Estateblissements Rene Beziere, S.A. v. Reid, Murdock & Co.*, 48 F. 2d 946 (CPPA), it was succinctly stated, at page 949:

“Apparently appellee did not have the right to use the mark in 1890, nor did appellant in 1893,

and as against each other neither could claim priority."

In *Robertson v. United States*, 287 Fed. 942, the Court of Appeals for the District of Columbia, pointed out, in the Opinion by the Chief Justice, at page 945:

"If, in a contest between a registrant and one who is using the same mark upon the same class of goods, the latter can establish that he is the owner of the mark, *the registration of it will avail the other party nothing.*"

Accordingly, Appellant's registration of the mark herein, "will avail it nothing", in view of third parties' ownership of the mark at the time appellant purportedly adopted the mark.

As was pointed out, in *The W.E. Long Co. Independent Bakers' Cooperative v. Burdett, supra* (134 USPQ 147), at page 151:

"Registration cannot confer a title to a trademark, if some other person has acquired a prior right by adoption and use; nor can it vest a title in the registrant as against the common law title of another person. *Coca-Cola Company v. Stevenson*, 276 F. 1010; *Carroll & Son Company v. McIlwaine & Baldwin, Inc.*, 171 F. 135."

It was similarly held by the Supreme Court of the United States with respect to corporate names as the cases have held with respect to trademarks:

*Goodyear's India Rubber Glove Manufacturing Co. v. Goodyear Rubber Co.*, 128 U. S. 598, 32 L. Ed. 535, 9 S. Ct. Rep. 166, was a suit by a corporation to restrain the use in business of the same or equivalent

name. Mr. Justice Field, in holding that such descriptive names could not be exclusively appropriated, said:

*“The principle that one corporation is not entitled to restrain another from using in its corporate title a name to which others have a common right, is sustained by the discussion in Columbia Mill Co. v. Alcorn, 150 U.S. 460, 37 L. Ed. 1144, 14 Sup. Ct. Rep. 151, and is, we think, necessarily applicable to all names *publici juris*. (citing authorities.)”*

The principle is equally applicable to the case at bar wherein plaintiff seeks to restrain defendant not only from using its trademark but also its corporate name. Accordingly, the Appellant not only is without property right in its trademark due to third parties' prior ownership of the mark but also because the name, in any event, is *publici juris* and not subject to exclusive appropriation. It, therefore, follows, as a necessary corollary, that, under either or both theories, the appellant is not entitled to any such restraint against the defendant.

The Second Circuit Court of Appeals, in *The Warner Brothers Company v. Jantsen, Inc.* (1957), 249 F. 2d 355, 115 USPQ 258, declared, at page 353, in holding that the mark CURVALLURE does not infringe the mark “A’LURE”:

*“The plaintiff asks too much in seeking a private monopoly in the common word ‘allure’ as applied to certain articles of feminine adornment and apparel. As the court found \* \* \* this word or coined words derived therefrom ‘have for a long period of years been utilized as advertising for various types of feminine accoutrements’.”*

In the recent case of *London Records, Inc. v. Audio Fidelity, Inc.*, 134 USPQ 142 (May 1962), registration of the trademark AUDIO FIDELITY was cancelled, where others in the trade had used the words and similar terms separately and in combination to describe their goods. It was there held:

“It is concluded that the term ‘audio fidelity’ is nothing more than an apt term for describing phonograph records and that respondent’s registration thereof is damaging to petitioner’s right to the free use of the term to describe phonograph records of its manufacture.”

To the same effect, the Appellant’s mark herein, TAPEWRITER, is “nothing more than an apt term for describing tape writers”, and that Appellant’s registration thereof “is damaging to defendant’s right to the free use of the term to describe” tape printers of its manufacture.

In the recent case of *Seven-Up Co. v. Get-Up Corp.*, 137 USPQ 871 (May 28, 1963) (D. Ct. ND Ohio), in an action for trademark infringement and unfair competition, in rendering judgment for defendant, the Court considered not only the prior registrations but also the generic nature of the mark. The Chief Judge pointed out, at page 873:

“I take it there can be no question here but that the word ‘UP’ does not in and of itself belong to plaintiff *exclusively*. It appears that *others used ‘UP’ as a suffix, if I may so denominate it, some years before plaintiff, and that a large number of other Companies have used it over the years and use it today.*



“‘UP’ in law is no more plaintiff’s property than the word ‘steel’ belongs to United States Steel or Bethlehem or twenty other Steel Companies.”

In *Spiegel v. Zuckerman*, 188 Fed. 63, the Second Circuit Court emphasized, at page 64:

“Many different persons used it, in many different places. *It is not necessary to find that any one of these has used the word as a trademark so long and so continuously that he, rather than complainants, is entitled to exclusive ownership. It is quite sufficient to dispose of this appeal to find, as we do and as the Circuit Court found that in and prior to 1901 the word PRINCESS was being used by so many different persons in connection with the sale of shirtwaists and similar garments, and had been so used for so long a time, that complainants could not, by adopting it as a mark for their own, acquire any exclusive right to its use as such mark.*”

The impropriety of injunctive relief in such case where plaintiff has not acquired exclusive right to use of the mark, was pointed out by *Nims* in *Volume 1* of his text on *Unfair Competition, 4th Edition*, in *Section 384*, as follows:

“*Defendant may attack the plaintiff’s title by asserting that some third party, perhaps a stranger to the suit, is the rightful owner of the mark and that the plaintiff is himself an infringer of that stranger’s rights. \* \* \* To maintain their bill for an infringement the plaintiffs are bound to show an exclusive right to use the mark. If it appears that the words were in common*



*use to designate the article of manufacture, or if the exclusive right to use them was vested in another, we apprehend that the plaintiffs are no more entitled to an injunction than is the patentee of an invention who fails to show that he is the first and original inventor of the thing patented.*

\* \* \* The fact that the defendant has no better right to the use of the trade-mark than the plaintiff *would certainly not entitle the latter to an injunction.* (Citing authorities).”

#### POINT IV.

**Appellant’s Use of Its Corporate Name Dymo as Its Primary Trademark Coupled With Use of Its Trademark Tapewriter as Descriptive of Its Product, the Tapewriter Mark Alone Cannot Be Held to Identify the Source of Origin or to Vest Exclusive Right of Use.**

The District Court’s finding “that there is *great doubt* as to whether or not the plaintiff has the exclusive right to use the word “TAPEWRITER”, was based not only on the question of Appellant’s ownership of the mark because of third parties’ prior rights thereto, but also on the fact that Appellant herein has been using its corporate name, *DYMO*, as its *primary* trademark, preceding the word *TAPEWRITER* which is merely descriptive of its product, while the primary mark *DYMO* is more conspicuously displayed as to lettering, size, and emphasis, and is known as a *DYMO* machine with the *DYMO* as the source of origin.

In the case of *Minnesota Mining & Mfg. Co. v. Sprague Electric Co.*, 126 USP Q240 (1950) (Re-hearing CCPA), the Court considered the meaning of

primary marks, in the mark, “UNIPAK” as applied to goods of both parties. It was held, at page 242:

“UNIPAK is used by appellant to identify and describe its container, not the source of its resins. Without exception, the many advertisements and other exhibits that appellant introduced in evidence show that UNIPAK modifies the container in which the resin are packaged, and that *the resins themselves are identified by the mark ‘SCOTCHCASE’*. \* \* \* .

*“It is apparent that appellant is endeavoring to condition the purchasing public to recognize ‘Scotchcase’ as the identifying mark of its resins and UNIPAK as the type of container used for them. We are not convinced that MMM’s registered UNIPAK mark has been so used that it has acquired trademark significance with respect to the epoxy resins of its manufacture.* \* \* \*

*“Opposer’s use of UNIPAK, not as a trademark for its merchandise (which is ‘Scotchcast’ resin), but as a secondary trademark only for the type of container in which that merchandise is sold.”*

The case at bar is *a fortiori*. Appellant, in addition to registration of the mark TAPEWRITER, has also registered the mark DYMO-MITE in the same Class 23 for embossing machines, and has registered the mark DYMO in Class 50 for its Embossing Tapes. Plaintiff’s Exhibit “D” [Tr. p. 14], shows its advertising material as “DYMO M-5 Tapewriter”, with the registration symbol after the word DYMO and not after the word Tapewriter, and with the word DYMO

in larger and heavier lettering than the word Tapewriter. In Exhibit "E" [Tr. p. 15] Appellant refers to its "New DYMO instant labelmaker", without even mentioning the word Tapewriter and with the registration symbol after the word DYMO. On the picture of the DYMO Tapewriter machine, it appears that words DYMO TAPEWRITER are molded onto the machine itself. Its Exhibit "B" [Tr. p. 12] refers to its DYMO MITE TAPEWRITER but the picture of the machine shows only the words DYMO MITE molded on to the machine without the word TAPEWRITER.

Accordingly, to paraphrase the aforesaid decision, "it is apparent that appellant is endeavoring to condition the purchasing public to recognize "DYMO" as the identifying mark of its products and "TAPEWRITER" merely as descriptive of its DYMO product.

The Supreme Court of the United States, in *Kellogg Co. v. National Biscuit Co.*, 305 U. S. 305 (1938), reversed an injunction in a suit to enjoin unfair competition in use of the name "SHREDDED WHEAT". Mr. Justice Brandeis, in holding that no exclusive right to its use may be acquired of a generic term, pointed out, at page 120:

"The Kellogg cartons bear *in bold script* the names 'Kellogg's Whole Wheat Biscuit' or 'Kellogg's Shredded whole wheat Biscuit' *so sized and spaced as to strike the eye as being a kellogg product.* \* \* \*

"But the name *Kellogg* was *so prominent* on all of the defendant's cartons *as to minimize the possibility of confusion.*"

In the recent case of *General Controls Co. v. Hi-G, Inc.*, 136 USPQ 570 (Dec. 1962) (D. Ct. Conn.), where plaintiff sought injunction against use by defendant of its corporate name, the Court, in holding for Defendant in the action for trademark infringement and unfair competition, pointed out, at page 576:

*“Finally, since the plaintiff prominently features both its primary mark ‘GC’ and its corporate name in full in all advertisements in which its trademark ‘hi-g’ appears, the mark ‘hi-g’ standing alone cannot be held to have taken on a secondary meaning as a source of origin of products made by General Controls. The fact is that the plaintiff has never weaned the ‘hi-g’ mark from its parent.”*

In the recent case of *Wembley Inc. v. Diplomat Tie Co.*, 137 USPQ 107 (March 1963) (D. Ct. D. Md), in an action for trademark infringement and unfair competition, the Court, in holding for the defendant, pointed out, at page 119:

*“This construction by plaintiff of its own alleged trademark, although not binding this court, is not without significance and indicates that ‘Color’ is the dominant word in ‘Color Guide’.”*

It, similarly, is not without significance that Appellant’s own construction of its trademarks indicates that “DYMO” is its primary trademark and the dominant word in “DYMO TAPEWRITER”. Such construction is fortified by its use of the registration symbol after the word “DYMO” and not after the word “TAPEWRITER”, as shown by the Record.



## POINT V.

### Appellant's Misuse of the Registration Symbol on Its Trademarks Bars Any Right to Relief.

It appears from the Record that Appellant's registration of the name "DYMO" was for its tape product in Class 50 and not for its embossing machines in Class 23, and that its application for registration in Class 23 for its embossing machines was filed November 26, 1962 and still pending, and that the use of the registration symbol in advertising the "DYMO" mark on its embossing machines prior to such registration, bars the right to any relief.

In a case in the New York Supreme Court it was held on an appeal from an order denying a preliminary injunction to restrain the imitation of a soap wrapper, that an untrue statement on the wrapper, that the form of cake and wrapper "were protected by a trademark secured", was sufficient to bar the right to relief. (*Brown v. Doscher*, 49 N. Y. S. R. 196, 20 N. Y. Supp. 900.) This case subsequently reached the Court of Appeals on an appeal from a judgment dismissing the complaint. The latter court, in affirming the judgment on the ground that no infringement was shown, said: "If we had reached the conclusion that the plaintiff were entitled to judgment, then the legal question presented by this false statement would have required careful examination, but as the case stands we prefer to rest our decision upon the merits". (147 N. Y. 647, 42 N. E. 268.)

The Supreme Court of the United States, in *Worden & Co. v. California Fig Syrup Co.*, 187 U. S. 516 (1903), 47 L. Ed. 282, 23 S. Ct. 161, long ago declared it "well settled" that the owner of a trademark



seeking to enjoin another from injuring him by false representation, cannot ask aid of equity where he is guilty of misrepresentation in trademark which he seeks to protect. It was stated, at page 528:

“When the owner of a trademark applies for an *injunction* to restrain the public, *it is essential* that the plaintiff should not in his trademark, or in his advertisements and business, be himself guilty of any false or misleading representation; that if the plaintiff makes any material false statement in connection with the property which he seeks to protect, he *loses his right to claim the assistance of a court of equity.*”

The Court concluded, at page 537:

“*It is well settled* that if a person wishes his trademark property to be protected by a court of equity, he must come into court with clean hands, and if it appears that the trademark for which he seeks protection is itself a misrepresentation to the public by fraudulent misrepresentations in advertisements, *all relief will be denied to him.* This is the doctrine of the highest court in England, and *no court has laid it down with any greater stringency than the Supreme Court of the United States.*

“The more recent cases evidence no disposition to modify the rule.”

In following the quoted rule, the Court, in *Channell Chemical Co. v. H.W. Hayden Co.*, 222 Fed. 163 (D. Ct. ND Ohio), held, at pages 163-5:

“*But there is in this case an insuperable objection to giving the complainant any relief whatever.*

(Quoting *Worden v. California Fig Syrup Co.*, *supra*).

“On this showing of deceptive advertising, we do not feel inclined to permit the complainant to have the advantage of an injunction out of this court to protect its map work, and thus indirectly protect it in its polish trademark over a product to be used generally with its mop. \* \* \*

“This situation leaves the case without any equity in favor of the complainant.”

#### POINT VI.

**Appellee Relies on Controlling Authorities in This Circuit. The Most Recent Decisions by the Ninth Circuit Court Held That Such Marks Are Not Confusingly Similar.**

The elements of infringement and the standards to be used, were treated by this Court in the recent case of *Plough, Inc. v. Kreis Laboratories*, 314 F. 2d 635, decided by the United States Court of Appeals for the Ninth Circuit on February 20, 1963 (Rehearing Denied March 26, 1963).

In this most recent authority on the subject, this Court held the defendant's trade-marks, “COCA TAN” and “COCA TINE”, *not* confusingly similar to the plaintiff's trade-mark, “COPPERTONE”, a word which had acquired an established secondary meaning in prior litigation, both parties' marks being affixed to containers of suntan lotions, and also that defendants are not now infringing or damaging any rights plaintiff has in the names “Copa Tan, Copa Tine and Copa Cream” by reason of defendant's trademarks “COCA TAN and COCA TINT”.

The Court pointed out, at page 4, that: “We have heretofore agreed with the *Restatement of Torts, Sec. 729*, that the test in determining possibility of confusion is *appearance, pronunciation and verbal translation*”, and, after discussing the differences in phonetic sound, made the distinction, at page 6: “We keep in mind we are concerned here with a *secondary meaning* existing only as to one of the words mentioned in the injunction—the word Coppertone. *No secondary meaning was alleged, claimed or proved* as to Copatine or Copatan”.

The Court pointed out, further, at page 7:

“*But one of the better ways to prove likelihood of confusion in the future is to prove it existed in the past. We cannot say there does exist a likelihood of any confusion, on the sparse record before this court. There is not one word of evidence as to the impact or effect of the supposed similarity of the products upon the market. (Citing authorities).*”

The Court observed, at page 7:

“By its filing of this proceeding, appellant attempts, not to prevent competition with any product it produces under the name of Copatan, Copatine or Copacream (for it produces none), but *to prevent the marketing in the competitive market of any product marked so that it might* (Court’s italic) *remind one of Coppertone.* \* \* \* We cannot read, on the evidence before us, any intent to palm off ‘Coca Tan’ or ‘Coca Tint’ as ‘Coppertone’ ”.

The Court pointed out, at page 8:

“There is an utter lack of proof:

“(a) of confusion of one person buying ‘Coca Tan’ thinking it was ‘Coppertone’ or ‘QT’ or ‘Royal Blend’, or even that it was ‘Copatan’;

“(b) That the *packages* looked similar or alike;

“(c) That the names of the products *sounded* similar or alike, as was the case in several of the cases cited in the dissenting opinion;

“(d) that there was any *exact copying*;

“(e) That there was any *effect* upon prospective customers.

*“We are convinced a two-word trademark has a different visual impact on the public than would a one-word trade-mark. \* \* \**

“There existed in the record *no evidence of injury or damage*, or probable injury or damage.  
\* \* \*

*“The burden of proving the violation rested on appellant.”*

The Court held further, at page 9:

*“The mere use of a name which appellees had a right to use cannot in and of itself constitute unfair competition. (Shredded Wheat—Kellogg Company v. National Biscuit Company (1938), 305 U.S. 111, 59 S. Ct. 109; “Wheaties vs Oaties”—Quaker Oats Co. v. General Mills, Inc., 7 Cir. 1943, 134 F. 2d 429.”*

In the case at bar, similarly, the defendant’s mark is a two-word trademark, to wit, “TapePrinter”, having a visual impact different from plaintiff’s one-word



trademark TAPEWRITER, in addition to having a different “verbal translation” of the suffix “printer” than the plaintiff’s suffix, “writer”, and the two being different also in appearance and pronunciation, as pointed out by the Court in the cited case. Here, too, similarly, there is an “utter lack of proof” of “confusion of one person buying” a tape-printer thinking it was plaintiff’s DYMO TAPEWRITER; or that the “packages looked similar or alike”, or that the names “sound” alike, or that there was any “exact copying” or that there was any “effect upon prospective customers”; and, here, too, “no secondary meaning was alleged, claimed or proved” as to TAPEWRITER. And, similarly, in the instant case, by its filing of this proceeding plaintiff attempts not to prevent unfair competition but “to prevent the marketing in the competitive market of *any* product” that “*might*” be competitive. The conclusion is, similarly applicable here, too, that “we cannot read, on the evidence before us”, “any intent to palm off” TapePrinter as DYMO Tapewriter.

In a dissenting Opinion written in the case, the distinction was made of cases involving secondary meaning, at page 20, as follows:

“If this were a contested case in which the plaintiff was trying to procure an injunction which was resisted by the defendant, the question of whether plaintiff could claim an exclusive right to a certain name might involve a consideration of whether that name was one which must acquire a secondary meaning. But such is not the situation here.”



Nor is such the situation in the case at bar, wherein the plaintiff does not even claim that its trademark TAPEWRITER could have acquired any secondary meaning, on the Record herein.

It is noteworthy that the Ninth Circuit Court's decision in the aforesaid most recent case of *Plough, Inc. v. Kreis Laboratories, supra*, upon which defendant relies as a controlling authority herein, cited in its Opinion the "Shredded Wheat" case decided by the *Supreme Court of the United States, Kellogg Company v. National Biscuit Company* (1938), 305 U. S. 111, 59 S. Ct. 109.

In that case, the Supreme Court reversed a decree of injunction in a suit to enjoin unfair competition in use of the name "Shredded Wheat". Mr. Justice Brandeis there pointed out, at page 116:

"The plaintiff has no *exclusive right* in the use of the term 'Shredded Wheat' as a trade name. For that is a *generic term of the article, which describes it with a fair degree of accuracy.*  
\* \* \* Since the term is *generic*, the original maker of the *product acquired no exclusive right to use it.*"

It, therefore, follows, as a necessary corollary, in the case at bar, that, since the mark TAPEWRITER "is a generic term of the article which describes it with a fair degree of accuracy", the "plaintiff has no exclusive right in the use of the term" as a "trade name", and "acquired no exclusive right to use it".

The Court there also pointed out that “the name Kellogg was so prominent on all of the defendant’s cartons as to minimize the possibility of confusion”.

Similarly, in the case at bar, the plaintiff’s name DYMO is “so prominent on all of the cartons as to minimize the possibility of confusion”.

In another recent case of the Ninth Circuit, *Miles Laboratories, Inc. v. Frolich*, 132 USPQ 122 (Dec. 1961), this Court held that Milk-O-Seltzer does not infringe Alka-Seltzer nor does it unfairly compete therewith, and affirmed the judgment of the District Court “on the basis of the well-reasoned opinion” of the District Court Judge in 195 F. Supp. 256, 130 USPQ. In the lower court decision it was pointed out that the word “Seltzer” is not registrable as applied to anti-acide effervescent preparation since it is a descriptive word. It was pointed out, at page 21:

“It has been correctly pointed out that little can be gained from the citation of specific cases since each must be decided on its particular facts. (Citing authorities). However, it is important to note the trend of decisions within the circuit by which this court is bound. (Citing authorities).”

The Court pointed out further, at page 22:

“The only recent case arising within this circuit which the court has found (and none was cited) where the products were very similar and the question turned on the similarity of the names is that of *Vita-Var Corporation v. Alumaton Corporation*, SD Cal. 1949, 83 F. Supp. 214, 81 USPQ

330. In that case, Judge Yankwich, later Chief Judge of this District, held that 'Alumatone' was not confusingly similar to 'Alumikote' where the names were both applied to aluminum paint products. In that case, as here, *part of the names was identical*; \* \* \* If anything, the case before this court now is a stronger one for denying relief since part of the alleged infringing mark is a familiar English word which is unlikely to be confused.

"Until our circuit more clearly defines these cases, it seems that the *Vita-Var* case is more indicative of the position of this circuit than the decisions of other circuits which may go further in granting trademark protection. \* \* \* However, the court has found no case in this circuit holding marks as dissimilar as the ones in this case to be infringing. \* \* \*

"The court is particularly impressed with the result in *Miles Laboratories v. Pepsodent Co.*, CCPA 1939, 104 F. 2d 205, 41 USPQ 738. Although *decisions of the Court of Customs and Patent Appeals* have no binding effect on this court, they *carry particular weight since they are decided by a three-judge court which specializes in this type of case*. In *Pepsodent*, the court held 'Pepso-Seltzer' registrable as not confusingly to 'Alka-Seltzer' when affixed to similar products. As in the Alumatone case, *supra*, the alleged in-

fringing mark was considerably closer than the mark in the case under consideration, since the middle vowel was connected to the first syllable rather than separated by a hyphen as in this case. Moreover, the first syllable there does not have the descriptive quality which ‘milk’ has in the present case. \* \* \*”

The Court concluded, at page 23:

“The only genuine similarity between the marks here is the use of the word ‘seltzer’, as the last syllable of both. As pointed out in *The Upjohn Company v. Schwartz*, 2 Cir. 1957, 246 F. 2d 254, 262, 114 USPQ 53, 59, such similarity is not uncommon in drug compounds. The word ‘seltzer’ is not registrable since it is a descriptive word.”

So it is in the case at bar. “The only genuine similarity between the marks here is the use of the word” “tape” as the first syllable of both. To paraphrase further, “such similarity is not uncommon” in tape products. The word “tape” is not registrable since it is a descriptive word. The words “writer” and “printer”, are equally descriptive, both common words of the English language denoting the nature of the product.

It, therefore, follows, as a necessary corollary, that Appellant cannot pre-empt the word TAPEWRITER, and that, in any event, the mark TapePrinter is not confusingly similar.

## POINT VII.

### The Term “Write” Has Been Held Descriptive and Incapable of Exclusive Appropriation.

The word “write” and its phonetic equivalent, “rite”, have been held by the Court to be descriptive.

Among the 570 marks shown by the Record herein to have been adopted using the word “tape” or “write” or “rite” as a portion thereof, a number were almost identical to the mark of the plaintiff, TAPEWRITER, such as TAPE-RITER, and TAPERITE.

In the case of *Rite-Rite Mfg. Co. v. Rite-Craft Co.*, 85 USPQ (1960) (CCPA) (37 CCP (Patents) 963), the word “RITE” was held to be a misspelling of “WRITE” and descriptive. The mark “*Rite-Craft*” was held not confusingly similar to “*Rite-Rite*”. It was stated, at page 269:

“The prefix *RITE*, appearing in the marks of both parties, *would ordinarily have the same meaning as the word ‘WRITE’, and because of such meaning the term ‘Rite’ is descriptive, and therefore not subject to exclusive appropriation by any dealer in goods similar to those of the parties.* \* \* \*

“From what has hereinbefore been stated, we are of opinion that *each of the marks may be used by the respective parties without likelihood of confusion and mistake in the mind of the public or deception of purchasers.*”



The same Court held, in *Clark Equipment Co. v. Baker-Lull Corp.*, 129 USPQ 220 (1961) (CCPA) (48 CCPA 865), that the marks YARDLOADER and YARDLIFT, having the same prefix, and having suffixes likewise conveying their common meaning, are so suggestive as to have little trademark significance, and pointed out, at page 221:

“That word is used to express its common, denotative meaning, viz, that the machines are primarily useful in a yard. \* \* \* The word loader is descriptive of the use of the machine, and the word ‘lift’ is denominative of the machine itself. Purchasers are more likely to associate either of the marks with the equipment irrespective of the manufacturer, than they are to associate the words with opposer, applicant or anyone else. \* \* \* The marks YARDLOADER and YARDLIFT *differ in meaning, appearance and sound.* \* \* \* No word more aptly describes the primary use of these machines than ‘loader’.”

Similarly, in the case at bar, “no word more aptly describes the primary use of these machines” than TAPEWRITER and TapePrinter, as descriptive of the function of the machines involved, to-wit, to write or to print on tape.

### POINT VIII.

#### Third Party Registrations Are Elements to Be Considered in Passing on Any Question of Likelihood of Confusion.

Notwithstanding defendant-appellee herein contests the validity of plaintiff-appellant's trademark by reason of prior third-party registrations, it has been held, in any event, that third party registrations have weight in showing that the prefix of a mark is either descriptive or suggestive and that such registrations have been held indicative that the mark is a "weak" mark without likelihood of confusion.

The Supreme Court of the United States took note of other registrations, in the case of *American Foundries v. Robertson*, 269 U. S. 372, and pointed out, at pages 380-383:

"The word 'SIMPLEX' is only a portion of the corporate name; \* \* \* it comprises the whole or a part of about *sixty* registrations by nearly as many different parties from many kinds of merchandise; and it forms part of the names of other corporations in the country. \* \* \* The word involved in this case is one of a large class of words which have for a great many years been much used because of their peculiarly suggestive meaning."

In a case involving tapes, *Johnson & Johnson v. Sun Chemical Corp.*, 131 USPQ 479 (1961) (PO TT&AB), third party registrations were held competent to show that the term had "a suggestive connotation as applied to goods of the character sold by the parties and to goods in general as a result of the

adoption by third persons of marks comprising this term". In that case it was held that PERMAFRESH and/or PERMAFRESH 500 did not so resemble PERMACEL and/or PERMACEL 500 for adhesive heat-sealing tapes, and like goods as to be likely to cause confusion in trade. Ten copies of registrations which issued to others, were introduced, for marks bearing the prefix PERMA, to show that PERMA was a suggestive term.

In another case involving this same tape product, *Johnson & Johnson v. Veon Chemical Corp.*, 127 USPQ 462 (Nov. 1960) (PA TT&AB) PERMA LINE was held not confusingly similar to PERMACEL. Numerous third party registrations were introduced into evidence to show that the term PERMA had been frequently adopted as a prefix of marks in allied fields.

In another such case, *Johnson & Johnson v. Permaspray Mfg. Co.*, 125 USPQ 22 (1960), it was held that PERMASPRAY and PERMACEL, though competitive goods, were not confusingly similar, and that the third-party registrations "clearly indicate that PERMA has the suggestive significance of PERMANENT as applied". To the same effect was *Johnson & Johnson v. Permachem Corporation*, 125 USPQ 501 (May 1960), wherein PERMACHEM and PERMACEL were held not confusingly similar; also *Johnson & Johnson v. Lawes Rabjohns Ltd.*, 126 USPQ 379 (1960) wherein PERMATRACE and PERMACEL were held not confusingly similar.

And in *Industrial Tape Corp. v. Reardon Co.*, 106 USPQ (1955), SUPERCEL was held not confusingly similar to PERMACEL. There were pointed out 31

registrations of marks having “cel” as the suffix for diverse items.

It has been held immaterial that any third-party registration may not be proven to be in use, in view of their purpose to show “that it has been a common practice for others to adopt the word as a part of trademarks for products in the field”. It was so held in *Motorola, Inc. v. Griffiths Electronics, Inc.*, 132 USPQ 565, which also held that, considering the suggestive nature of the word GOLDEN, descriptive GRID in THE GOLDEN GRID is sufficient to distinguish that mark from GOLDEN VOICE, GOLDEN VIEW, GOLDEN VEAM, GOLDEN M, GOLDEN SATELLITE, and GOLDEN HEART.

In *Goodall-Sanford, Inc. v. Tropical Garment Mfg. Co.*, 125 USPQ 189 (1960) (CCPA), it was pointed out, at page 190, that ROYAL PALM with palm tree was not likely to be confused with ROYAL BEACH with two palm branches, both used on wearing apparel; that “the word PALM is lacking in distinctiveness as a part of trademarks in the textile field and as such has only weak trademark significance” and that “This is shown in the record here by *ten registrations of third parties* in which the word Palm appears as a part of these marks for clothing and related goods.

In *E. L. Bruce Co. v. American Termicide Co. Inc.*, 128 USPQ 341 (1961) (CCPA) (48 CCPA 762), confusion was held not likely between TERMICIDE and TERMINIX. It was pointed out, at pages 341-342:

“The record recites registration and use by third parties of numerous marks comprising TERM and



TERMI for insecticides and termite control services. The examiner held that TERMICIDE and TERMINIX are both highly suggestive that the goods and services of both parties are designed to eliminate, kill or control termites. \* \* \* We doubt that the purchasing public relies on TERMI to indicate the *source* of the products or services because of the inherent weakness of that prefix, *and because of the many termite exterminators who have used it in their marks as indicated by the third party registrations \* \* \* .*”

In *U. S. Rubber Co. v. B. F. Goodrich Co.*, 135 USPQ 465 (Dec. 1962), in holding not confusingly similar the mark CIRCLE GRIP for footwear and the mark GRIPS for shoes, it was stated, at page 465:

“The fact that a number of these registrations have expired or that the registered marks have been discontinued does not, however, negate their evidentiary value in establishing the adoption by others in the footwear industry of marks comprising these various designations. (Citing authority). \* \* \* In view thereof, opposer’s mark cannot be afforded but a limited scope of protection. \* \* \* ”

In *Royal Petroleum Corp. v. River States Oil Co.*, 136 USPQ, in holding that likelihood of confusion does not exist as between ROYAL, ROYALUBE, ROYAL WITH BACK RS, or ROYAL 76, it was stated, at page 80:

“River States attached a number of copies of registrations disclosing marks consisting of or comprising the word ROYAL for goods akin to



those of the parties here involved. There are nineteen such registrations, the first of which issued in 1881 and the last of which issued in 1958 for the mark CONOCO ROYAL. \* \* \* *These registrations are indicative* that in the past, and for many years, the Patent Office considered ROYAL to be a ‘weak’ mark and that composite marks including said term were registerable for like goods on the basis of no likelihood of confusion \* \* \* *It has been consistently held* that trademarks will not ordinarily be held confusingly similar because each of them includes a word of that type. (citing authorities).”

In *Home Decorators, Inc. v. Ecco Products Co.*, 130 USPQ 153 (1961) (CCPA) (48 CCPA 1038), the word PRESTIGE was held to be a common English word suggesting a connotation of quality, and, it was pointed out, at pages 154-155: “It has been registered many times for many different kinds of merchandise”, and the decision concluded:

“We doubt that the registration of this word for bathroom, kitchen and closet accessories will dilute the word for trademark purposes or ‘cause great damage to the image’ to any appreciable degree greater *than has already been done by these other registrations.*”

In *Hiram Walker & Sons Inc. v. Milstone*, 130 USPQ 274 (1961), the marks CANADIAN CROWN and CANADIAN CLUB, both for whiskey, were held not confusingly similar. Copies of seventy-five third-party registrations were introduced for the purpose of establishing that the words were not in and of themselves distinctive as applied to whiskey.

In *Teleflex Inc. v. Telerad Mfg. Corp.*, 127 USPQ 357 (1960), (D. Ct. SD NY), it was held worth noting, in determining strength of TELEFLEX mark, that registration had been granted to TELEFAX, TELEFACTS, TELE-FIX, TITEFLEX and TEL-FLEX on various products.

In *Sakrete Inc. v. Slag Processors, Inc.*, 127 USPQ 134 (1960), purchaser confusion was held not likely between SLAGCRETE and SAKRETE. It was pointed out, at page 134, that the Court of Customs and Patent Appeals “clearly indicated that third party registrations are admissible in evidence to show that a prefix or suffix of a mark is either descriptive or suggestive”.

In *William L. Bonnell Company Inc. v. Marglo Inc.*, 131 USPQ (1961), numerous third-party registrations were introduced to show that the marks which include the word “trim” have been frequently adopted for trim or molding material. The mark, TRIM-BRITE for plastic tape with adhesive backing, was held not likely of confusion with TRIMEDGE for plastic mouldings, TRIM-A-LUSTER for metallic trim mouldings, and TRIMENDS and TRIMALITE for plastic mouldings and TRIMEDGE for a plastic tape for molding.

In *Fleetwood Co. v. Mende*, 132 USPQ 458 (1962) (CCPA), wherein it was held confusion was not likely to arise from use of “Tint 'N Set” and “Tintz” on hair tinting preparation, the Court pointed out the weakness of the mark as an indicator of source or origin of the goods, as confirmed by the eleven third-party registrations involving the word “tint” as part of

the trademark for similar goods, and stated, at page 459:

*“The significance of third party registrations was set forth by us in Shoe Corp. of America v. The Juvenile Shoe Corp of America, 46 CCPA 868, 266 F. 2d 793, 121 USPQ 510, 512-513, where we stated: ‘If it has been frequently so used, the inference is warranted that it would be likely to be understood by purchasers as identifying or describing the merchandise itself, rather than the source thereof’. \* \* \**

*“It is unnecessary to cite the numerous other cases of this court wherein the scope to be given to weak trademarks was discussed. It seems both logical and obvious to us where a party chooses a trademark which is inherently weak, he will not enjoy the wide latitude or protection afforded the owners of strong trademarks. Where a party uses a weak mark, his competitors may come closer to his mark than would be the case with a strong mark without violating his rights. The essence of all we have said is that in the former case there is not the possibility of confusion that exists in the latter case.”*

The Oregon Supreme Court pointed out, in the case of *88¢ Stores, Inc. v. Martinez*, 129 USPQ 491 (May 1961), at page 494:

*“A corporation, in selecting for a trade name a generic term which is descriptive of the business in which it proposes to engage, assumes some risk of injury resulting from confusion of trade names, since no one can exclusively make such an appropri-*

ation. \* \* \* There are, no doubt, *several hundred firms* \* \* \*. *Why should one company be permitted thus to monopolize a trade name of such character?* If an exclusive appropriation can thus be made, then, with like reason, there might be a *monopoly* in the use of such names as ‘Adjusters’, ‘Printers’, and ‘Lawyers’.”

The Court concluded, at page 497:

“But the courts have generally rejected such claims to exclusive use. \* \* \*

“The conflict may be roughly described as one between the principles of monopoly and competition. \* \* \*

“The clear trend of the cases is in the direction of recognizing the right to compete.”

As Judge Learned Hand identified the problem, in *Shredded Wheat Co. v. Humphrey Cornell Co.*, 250 Fed. 960, 964 (2d Cir.):

“Under the guise of protecting against unfair competition, we must be jealous not to create perpetual monopolies”.

The case at bar is *a fortiori*. The Record herein shows 574 third-party trademarks and tradenames, insofar as presently known, which include either the term “tape” or the word “write” or its phonetic equivalent “rite”, for goods stated to be in various phases of the tape field, and in other fields for a variety of products, including registrations in the United States Pat-



ent Office, State Registrations and Common Law listed marks.

It has been juducially declared that the greater the number of similar third party registrations or third party trade names or trade marks, already in use, the less likelihood that their products will be associated or attributed to one source. The number of third party registrations shown herein exceed the number of those in any of the cases cited. Exhibits "A" through "D" [Tr. pp. 90-140] list the trademarks and tradenames, including a number of affidavits from third-party registrants and users establishing their adoption and use of the mark prior to the Appellant's registration of the trademark in question herein.

Why words, merely descriptive of the goods sold, receive no protection, was cogently stated by Judge Learned Hand in *Oakland Chemical Co. v. Bookman*, 22 F. 2d 930, 931:

*"A 'descriptive' mark is bad for two reasons: First, because it does not in fact advise the public that the goods come from a 'single source' (Coca-Cola v. Koke Co., 254 U.S. 143, 146, 41 S. Ct. 113, 65 L. Ed. 189); second, because, if it did, since the word describes the goods, the protection of the mark would trench upon common speech which should do the same." (Citations omitted).*



The Supreme Court of the United States, in *Canal Co. v. Clark*, 13 Wall. 311, 323, stated:

“He has no right to appropriate a sign or symbol, which, from the fact it is used to signify, others might employ with equal truth, and therefore have an equal right to employ for the same purpose.”

As was expressed in *Dobeckman Co. v. Boston Packaging Machinery Co.*, 107 USPQ 350 (1955), wherein “ZIP-TAPE” was held not infringed by “ZIP-CORDER”, the Court, in dismissing the Complaint in the action for trademark infringement and for injunction, declared, at page 351:

“If a party chooses an unstable mark, he must accept the consequences.”

## POINT IX.

A Survey of Recent Cases Shows the Trend of Decisions Holding No Likelihood of Confusing Similarity. The Case at Bar Is A Fortiori.

### MARKS HELD NOT CONFUSING

Mark	Product	Citation (Year 1963)
COZY CUFFS COZY TOES	slipper socks house slippers	<i>Shoe Corp. of America v. Robert Hosiery Mills, Inc.</i> , 137 USPQ 912
THERAMIN THERAPAN	therapeutic vitamins same	<i>Chase Chemical Co. v. Arcum Pharmaceutical Corp.</i> , 137 USPQ 910
SENTOL SEN-TROL	detergent for cleaning equipment dish washing solution	<i>The Russell Chemical Co. v. Wyandote Chemicals Corp.</i> , 137 USPQ 908
LIDOCATION LIDOCAINE	dental and medical anesthetic same	<i>Astra Pharmaceutical Products v. Pharmaton S.A.</i> , 137 USPQ 899
FLEXAC FLEX-VAC	polyvinyl acetate emulsions same	<i>Standard Packaging Corp. v. Air Reduction Co.</i> , 137 USPQ 895
DUREL DUREEN	plastic surface laminated panel plastic surfaced panels	<i>Caradco Inc. v. West Virginia Pulp &amp; Paper Co.</i> , 137 USPQ 910
FRESK FRESHIE	preparation for making beverages concentrate for making drinks	<i>Sunway Fruit Products Inc. v. Productos Caseros S.A.</i> , 138 USPQ 162
GET UP 7 UP	soft drinks same	<i>Seven-Up Co. v. Get-Up Corp.</i> , 137 USPQ 896
JAG-KNIT JAEGER	men's hosiery same	<i>The Jaeger Co. Ltd. v. Kayser-Roth Corp.</i> , 137 USPQ 908
CUSH UN SOFT CUSHION-STEP	ladies shoes arch shoe for women	<i>Godman Shoe Co. v. Dunn &amp; McCarthy Inc.</i> , 137 USPQ 896
TANTAPAK TAN-Ti-Cap	capacitor assemblies capacitors	<i>Texas Instruments Inc. v. Sprague Electric Co.</i> , 137 USPQ 454
TEA BREAK TEA TIME	tea same	<i>In re Martin Gillet &amp; Co. Inc.</i> , 137 USPQ 618
POLY-VUE POLAROID	slidefilms projectors photographic apparatus	<i>Polaroid Corp. v. Richard Manufacturing Co.</i> , 137 USPQ 488
LULL-A-BABLE LULLABY	nursing bottles and nipples nursing nipples and bottle holders	<i>Dunhill International Inc. v. Lull-A-Babe Inc.</i> , 137 USPQ 232
CIRCUITRIM CIRCUITRIM	variable resistors same	<i>Bourns Inc. v. International Resistance Co.</i> , 138 USPQ 95
BASINEX (HYPINEX, ONEX (RAPONEX (JAPONEX	insecticides plant food, rat killer bait rat and mouse killer bait insecticide	<i>Hydroponic Co. v. Badnische A.G.</i> , 138 USPQ 94

Mark	Product	Citation
AEROMAGIC (AERO (AEROWAX (AEROMIST (AERO SHAVE (AERO SNOW	aerosol starch and tar remover mops and cleaning fluids self polishing floor wax glass cleaner and sprayer aerosol shaving lather artificial snow	<i>General Aerosols Inc. v. American Home Prod. Corp.</i> , 138 USPQ 60
TRUCK-LITE TRIPPE SAFETY LIGHTS	automotive lamps electric head lights	<i>Trippe Manufacturing Co. v. Truck-Lite Co. Inc.</i> , 137 USPQ 912
FLAVOR TREAT (LEMONADE TREAT (APPLE TREAT (ORANGE TREAT (CHERRY TREAT (GRAPE TREAT (ETC TREAT	beverages same	<i>Westfield Food Products Inc. v. Sunkist Growers, Inc.</i> , 137 USPQ 911
CONDADOS CONDADO	women's shoes piece goods for dresses, etc.	<i>David Crystal Inc. v. International Shoe Co.</i> , 137 USPQ 911
LOKFIN LK-FIN	Finned Tubing same	<i>In re Calumet &amp; Hecla Inc.</i> , 137 USPQ 910
UNI-CHECK UNI-CHECK	controls for pneumatic cylinder builders' hardware, door checks	<i>Oscar C. Rixson Co. v. Deschner Co.</i> , 137 USPQ 909
SELECTRON SELECTRON	electronic control system current rectifier	<i>The DoAll Co. v. Noble Co.</i> , 137 USPQ 909
ORLAINE ORLANE	watches cosmetic products	<i>Jean D'Albret Sarl v. Benrus Watch Co. Inc.</i> , 137 USPQ 909
INSUL SHIELD INSUL SHIELD	insulating pipe hangers emulsion in waterproof to insulate	<i>The Lubrizol Corp. v. Insul-Coustic Corporation</i> , 137 USPQ 908
CASCADE CASCADE	prepared baking mix whiskey	<i>George A. Dickel Co. v. General Mills Inc.</i> , 137 USPQ 990
DECISION NEWSLETTER DECISION	religious newspaper guide for seeking a career	<i>Decision Inc. v. The Billy Graham Asso. Inc.</i> , 137 USPQ 801
MYSTIC MIST MAGIK MAGIK MIST	silicone fabric spray chemical products spray insecticide dispensers	<i>Knapp-Monarch Co. v. Dumas Mitner Corp.</i> , 137 USPQ 614
L'AIMANT L'AIMANT RED	toilet waters and face powder cosmetic and toilet preparations	<i>Coty Inc. v. Iwasaki</i> , 137 USPQ 487
MASTERPIECE (DUTCHMASTERS (THE MASTER CIGAR	tobacco cigars cigars	<i>Consolidated Cigar Corp. v. Liggett &amp; Myers Co.</i> , 137 USPQ 483
SUN VALLEY SUN VALLEY	jackets and sport underwear overshoes	<i>Cambridge Rubber Co. v. Sun Valley Manufacturing Co.</i> , 137 USPQ 384
PREMIUM POP PREMIUM	popcorn in its raw state biscuits	<i>National Biscuit Co. v. Princeton Mining Co. Inc.</i> , 137 USPQ 250



Mark	Product	Citation
SACHES OF CALIFORNIA PAUL SACHS ORIGINAL	dressess "Young Missy" misses dresses	<i>Paul Saches Originals Co. v. Sachs</i> , 137 USPQ 240
CHEMFOAM, KEMFOAM CHEMFOAM	mattresses and box springs foamed materials forming sheets	<i>In re Englander Co. Inc.</i> , 137 USPQ 233
FASION GUIDE COLOR GUIDE	ties same	<i>Wembley Inc. v. Diplomat Tie Co.</i> , 137 USPQ 107
TRAN-Q (TRAN (ALVA-TRAN (TRANQUIL	tranquilizing compound therapeutic tablets pharmaceutical preparations pharmaceutical preparations	<i>Alva Tranquil Corp. v. Charles Pfizer &amp; Co. Inc.</i> , 137 USPQ 81
LONG-GLO LONG AID	hair dressing preparations same	<i>Keystone Laboratories Inc. v. Valmor Products Co.</i> , 136 USPQ 679
LAB-TEK (LAB aid (TECHNICON	hospital laboratory equipment same same	<i>The Technicon Co. Inc. v. Labtek Plastics Co.</i> , 136 USPQ 677
"3 Way" "4 Way"	hair spray preparations for colds relief	<i>Grove Laboratories Inc. v. Shutton Inc.</i> , 136 USPQ 676
SETHCO SELCO	filtering products same	<i>The Cellulo Co. v. Sethco Manufac- turing Corp.</i> , 136 USPQ 675
CARE-AIRATOR CARbureTER	compensators for engines same	<i>ACF Industries, Inc. v. General Motors Corp.</i> , 136 USPQ 675
EPINOR DEPINAR	ophthalmic solution vitamin B-12	<i>Armour Pharmaceutical Co. v. Barnes- Hind Laboratories Inc.</i> , 136 USPQ 675
SHOW BUSINESS SHOWBIZ	show business newspaper title for cartoon panel	<i>Leo Shull Pub. Inc. v. Newspaper Enterprise Asso.</i> , 136 USPQ 675
FLEXI-PHRAGM FLEX-FLO	valves controlling fluids same	<i>Grove Valve &amp; Regulator Co. v. G.W. Dahl Co. Inc.</i> , 136 USPQ 673
PERMA BED PERMACEL	bedding adhesives and sealers adhesives and sealers	<i>Johnson &amp; Johnson v. Biddle Co.</i> , 136 USPQ 666
SEASORB BIO-SORB	pharmaceutical preparation pharmaceutical powder	<i>Ethicon Inc. v. Stiefel Laboratories Inc.</i> , 136 USPQ 665
DAIRY CHARM COUNTRY CHARM	butter dairy products	<i>Cooperative Quality Marketing Inc. v. Dean Milk Co.</i> , 136 USPQ 645
LINO LEGO	bricks same	<i>Interlego A.G. v. Leslie-Henry Co. Inc.</i> , 136 USPQ 601
Hi-G hi-g	electric relays valves and control systems	<i>General Controls Co. v. Hi-G, Inc.</i> , 136 USPQ 570
SUNSHOWER SUN	cream shampoos detergents	<i>La Soap Co. v. John H. Breck, Inc.</i> , 136 USPQ 488
TRUSS-SKIN TRUSCON	sheet metal for buildings steel products	<i>Republic Steel Corp. v. MPH Manu- facturing Corp.</i> , 136 USPQ 447

Mark	Product	Citation
INSTAGNESIC INSTANTINE	analgesic antirheumatic analgesic	<i>Sterling Drug Co. v. Colgate Palmolive Co.</i> , 136 USPQ 317
BLUE FERN BLUE GRASS	perfume and cologne soap and perfumes and perfumery	<i>Elizabeth Arden Sales Corp. v. Purex Corp. Ltd.</i> , 136 USPQ 276
WALLACE WALLACE SUPER DIETARY MEALZ	prescription goods and drugs dietary food	<i>Carter Products Inc. v. Fleetwood Co. Inc.</i> , 136 USPQ 252
JOY JOY OF BATHING	perfume and toilet water bath oil preparatoin	<i>Jean Patou Inc. v. Jacqueline Cochran Inc.</i> , 136 USPQ 236
GINI NEHI	soft drinks same	<i>Royal Crown Cola Co. v. Pure Spring</i> , 136 USPQ 228
SILICOTRIG SILICONTROL	electric phase controllers electrical phase shifters	<i>Vec Trol Engineering Inc. v. Bergen Laboratories Inc.</i> , 136 USPQ 283
PHARMATINIC ARMATINIC	iron composition granules containing iron	<i>Armour &amp; Co. v. Pharmachem Specialties Inc.</i> , 135 USPQ 365
SPORTSMASTER (SKATE MASTER (SCORE MASTER	baseball gloves, baseballs roller skates leather shoes, athletic	<i>L. N. Schwartz &amp; Sons, Inc. v. Liberty Distributors</i> , 135 USPQ 366
NOVOPHALT (NOVOPLY (NOVOCORE (NOVOTILE (NOVODOR (NOVOWALL (NOVOTEX	anti-corrosion, insulation wood particles boards of wood particles composition wood particles doors wood panels wood and lumber products	<i>U. S. Plywood Corp. v. Glaswerk Schuller G. mbH</i> , 135 USPQ 368
HEMOZYME (HEMO (HEMO-RATION	anemia tablets malted foods cereals for animals	<i>Borden Co. v. Barrows Chem. Co. Inc.</i> , 135 USPQ 370
INTERWOVEN (IN-WOV-IN (LIN-WOV-IN	hosiery same same	<i>Interwoven Stocking Co. v. Great Hosiery Mill</i> , 134 USPQ 43
KAYLENE KRYLENE	food wrap of polyethylene synthetic rubber in bags	<i>Polymer Corp. v. Papercraft Corp.</i> , 134 USPQ 45
SAFE-STEMS Q-Tips, Inc.	cotton buds (alleges descriptive)	<i>Q-Tips, Inc. v. Johnson &amp; Johnson</i> , 134 USPQ 139
VULKENE VULCAN	building wire same	<i>In re General Electric Co.</i> , 134 USPQ 190
ABBEY or FRAIR'S MONASTERY	bread same	<i>Cistercian Abbey of Virginia v. Friar's Products Co.</i> , 134 USPQ 193
SOCIETY DEBS STYLISH DEBS	shoes same	<i>Melville Shoe Corp. v. Lester Pincus Shoe Corp.</i> , 134 USPQ 338
PIC-A-NUT TAS-T-NUT	identical product same	<i>Tas-T-Nut Co. v. Variety Nut &amp; Date Co.</i> , 134 USPQ 349



Mark	Product	Citation
CEROLA and C-ROLA JUICE	juice	<i>Acerola Corp. v. Warner Davis Inc.</i> , 134 USPQ 378
CEROLAX and C-ROLA	same	
DYNAFAX (DYNACOLOR (DYNACHROME (DYNASTOP (DYNOL (DYNADOL (DYNADUAL	writing-camera photo film	<i>Dynacolor Corp. v. Beckman &amp; Whit- ley, Inc.</i> , 134 USPQ 410
THERMEX THERM-A-JUG	jugs beverage containers	<i>Knapp-Monarch Co. v. Poloron Prod- ucts, Inc.</i> , 134 USPQ 413
PACIFIC MAID PACIFIC PEARL	seafoods same	<i>Wendt v. Granger</i> , 134 USPQ 414
HOME STYLE ARCHWAY HOME STYLE gurley'S HOME STYLE		<i>Venn v. Goedert</i> , 134 USPQ 442
CLOUD MIST (MIST (SCOTCH MIST (HIGHLAND MIST	woolen piece goods garments	<i>Rogers Peet Co. v. Cosmopolitan Juniors Inc.</i> , 134 USPQ 459
ELECTRO VOX ELECTRO-VOICE	intercommunications system microphones etc.	<i>In re Electro-Fox Inc.</i> , 134 USPQ 463
IGA SHOPPERS FAIR SHOPPERS FAIR	trade name same	<i>Shoppers Fair of Arkansas, Inc. v. Sanders Co. Inc.</i> , 134 USPQ 545
NILATIL NILEVAR	pharmaceutical preparation steroid preparation	<i>G. D. Searle &amp; Co. v. Aktiebolaget Pharmacia</i> , 134 USPQ 582
NYLAFEX NYLAFLOW	tubing and hose same	<i>The Polymer Corp. v. Dayco Corp.</i> , 134 USPQ 582
TRENDLEY WEMBLEY	men's and boys' garments same	<i>Wembley v. Salant &amp; Salant Inc.</i> , 134 USPQ 582
POWDER UP PRETTY UP	cosmetic preparations same	<i>McHam v. Gold Seal Co.</i> , 134 USPQ 583
BEAUTIQUE LINCOLN BEAUTYware & BEAUTY CAN	waste baskets	<i>Lincoln Metal Products Corp. v. .....</i> , 134 USPQ 584
AREOLITE BAROLITE	acrylic finishes resin adhesives	<i>Rerolite Chemical Co. Inc. v. Amer. Marietta Co.</i> , 134 USPQ 584
PETROFLUX PARA-FLUX	plasticizers same	<i>The C. P. Hall Co. v. Golden Bear Oil Co.</i> , 134 USPQ 586
GOLDEN TOUCH GOLDEN FLEECE & GOLDEN STAR	facial tissues	<i>Golden Fleece Tissue Mills, Inc. v. Swanee Paper Corp.</i> , 134 USPQ 586

Mark	Product	Citation
ACEROLA ACEREX	dietary supplements	<i>Acerex Products, Inc. v. Warner Davis, Inc.</i> , 134 USPQ 586
HIDE VYNAHYDE	plastic film	<i>Neumann &amp; Co. v. Bon-Ton Auto Upholstery, Inc.</i> , 134 USPQ 587
FYTE FLIT	disinfectants and deodorants same	<i>Humble Oil &amp; Refining Co. v. Hysan Products Co.</i> , 134 USPQ 587
LAWNSMITH LAWNBOY	power lawn mowers	<i>Outboard Marine Corp. v. Yuba Power Products, Inc.</i> , 134 USPQ 587
TEMP-GARD TEMP-GARD	paints aluminum storm windows	<i>Season-All Sales Corp. v. Benjamin Moore &amp; Co.</i> , 134 USPQ 587
NORTHMIST MIST HIGHLAND MIST SCOTCH MIST	threads and yarns men's apparel	<i>Rogers Peet Co. v. Northern Yarn Mills</i> , 134 USPQ 587
VET-A-MIX VETS'	vitamin etc. for stock canned dog and cat food	<i>Park Foods Co. v. Vet-A-Mix Inc.</i> , 134 USPQ 587
TRANSEC TRANSACTER	office dictating machines electrical data systems	<i>General Time Corp. v. Anderson Associates, Inc.</i> , 134 USPQ 587
VIE VIM	detergent preparations same	<i>Lever Brothers Co. v. The Winzer Co. of Dallas, Inc.</i> , 134 USPQ 589
CLIPPER CRAFT KLEPPER	boats same	<i>Klepper et al v. Staley</i> , 134 USPQ 589
BAR-MASTER SODAMASTER	beverage dispensers same	<i>Carbonic Dispenser, Inc. v. BarMaster, Inc.</i> , 134 USPQ 589
REGINIE REGINA	women's coats textile fabrics	<i>Deering Milliken, Inc. v. Clyde Fashions, Ltd.</i> , 134 USPQ 590
PERMAN LINE PERMACEL	thermoplastic compound pressure-sensitive adhesive tape	<i>Johnson &amp; Johnson v. Veon Chem.</i> , 133 USPQ 393
FASHION MODES MODESS	women's garments women's goods	<i>Personal Products Corp. v. Kayser-Roth Corp.</i> , 133 USPQ 345
FLEXAC FLEXVAC	polyvinyl emulsions flexible packaging materials	<i>Standard Packaging Corp. v. Air Reduction Co.</i> , 133 USPQ 351
POLARAID POLARAID INC.	non-competing goods	<i>Polaroid Corp. v. Polaroid, Inc.</i> , 133 USPQ 67
REDI-ARC REDI-SET		<i>Air Products Inc. v. Marquette Mfg. Co. Inc.</i> , 133 USPQ 192
WIANCKO WINCO		<i>Wincharger Corp. v. Wiancko Engineering Co.</i> , 133 USPQ 378
CUP'O'Cola COCA-COLA or COKE		<i>Coca-Cola Co. v. Clay</i> , 133 USPQ 606
SIPOREX SEAPORCEL or SEAPORCLAD		<i>Seaporcel Metals Inc. v. American Siporex Corp.</i> , 133 USPQ 632



Mark	Product	Citation
CUP		<i>J.F.G. Coffee Co. v. Hafner</i> ,
GOOD CUP or FINE CUP		133 USPQ 693
UNIPEL		<i>United Co-Operatives, Inc. v. Cali-</i>
UNICO		<i>fornia Chemical Co.</i> , 133 USPQ 695
MODERN MATERIALS		<i>Materials Handling Lab. Inc. v. Indus-</i>
HANDLING		<i>trial Pub. Co.</i> , 133 USPQ 696
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ENGINEERING		
FUN FASHIONS		<i>Mercantile Stores Co. Inc. v. Cole of</i>
SUN FUN		<i>California, Inc.</i> , 133 USPQ 698
CLANSMAN'S CHOICE		<i>Austin, Nichols &amp; Co. Inc. v. Ewart</i>
CLAMS' PRIDE		<i>Thomson &amp; Sons</i> , 133 USPQ 700
MISS TEEN		<i>Watkins Products Inc. v. Daggett</i> ,
SWEETEEEN		133 USPQ 701
CUDDLAIRE		<i>Stardust Inc. v. Sel-Mor Garment Co.</i> ,
CUDDL'FORM,		133 USPQ 701
CUDDLE'TARD and		
CUDDL'BRA		
ELASTICSEAL		<i>Southport Paint Co. Inc. v. Kuhle</i> ,
PLASTICSEAL		133 USPQ 702
GALECOAT		<i>Alligator Co. v. B. W. Harris Manu-</i>
GOAL COAT		<i>facturing Co.</i> , 132 USPQ 97
MILK-O-SELTZER		<i>Miles Laboratories, Inc. v. Frolich</i> ,
ALKA-SELTZER		132 USPQ 122 (CA 9)
MISS BABETTE		<i>Mattel, Inc. v. Golberger Doll Mfg.</i>
BARBIE		<i>Co.</i> , 132 USPQ 243
CELACLOUD		<i>Huntington National Mattress Co. v.</i>
CLOUD, SIVER CLOUD,		<i>Celanese Corp.</i> , 132 USPQ 395
FLEECY CLOUD, etc.		
TOPP-COLA		<i>Topp-Cola Co. v. Coca-Cola Co.</i> ,
COCA-COLA		132 USPQ ....
MERITO	rum	<i>In re National Distillers v. Chemical</i>
MARQUES del MERITO	wines	<i>Corp.</i> , 132 USPQ 271
TINT 'N SET	hair tinting preparation	<i>Fleetwood Co. v. Mande</i> , 132 USPQ
TINTZ	same	458
DURA GREEN	grass seed	<i>Lee Patten Seed Co. v. Southern States</i>
DURA TURP	same	<i>Cooperative Inc.</i> , 132 USPQ 20
FROSTY		<i>Frostie Co. v. Sun-Glo Packers</i> ,
FROSTIE		<i>Inc.</i> , 132 USPQ 24
TINT	hair coloring	<i>Fleetwood Co. v. Lanolin Plus, Inc.</i> ,
TINTSTIK	same	132 USPQ 301

Mark	Product	Citation
KITCHENEER KITCHENAID	kitchen appliances same	<i>Hobart Mfg. Co. v. Rival Mfg. Co.</i> , 132 USPQ 301
DACA-BREEZE DAKS		<i>S. Simpson Ltd. v. Morris B. Sachs, Inc.</i> , 132 USPQ 518
DACA-BREEZE DACRON		<i>E. I. DuPont de Nemours &amp; Co. v. Morris B. Sachs, Inc.</i> , 132 USPQ
OXY-LYFE OXY-GEAR	oxygen inhalators	<i>Oxy-Gear, Inc. v. Mayer</i> , 132 USPQ 550
THE GOLDEN GRID GOLDEN VOICE, GOLDEN VIEW, GOLDBEAM, etc.		<i>Motorola Inc. v. Griffiths Electronics, Inc.</i> , 132 USPQ 565
NU RAY ACCURAY		<i>Industrial Nucleonics Corp. v. Curtiss-Wright Corp.</i> , 132 USPQ 649
BEAUTIFUL CROWN BEAUTIFUL HAIR	hair dressing	<i>John H. Breck, Inc. v. Hollingworth</i> , 132 USPQ 696
FORMAL TIME FORMALLY YOURS		<i>Wembley, Inc. v. Superba Cravats</i> , 132 USPQ 697
OKLAHOMA'S ORBIT ORBIT		<i>S. L. Allen &amp; Co. Inc. v. Oklahoma Publishing Co.</i> , 132 USPQ 697
TUOTITE DUOTEX	two-ply bags same	<i>Bemis Bro. Bag Co. v. Continental Can Co. Inc.</i> , 132 USPQ 697
COVER TREAT COVERMARK	fresh-tint make-up cosmetic	<i>Lydia O'Leary, Inc. v. Noxzema Chemical Co.</i> , 132 USPQ 699
CHURCH WINDOWS STAINED GLASS		<i>Wembley, Inc. v. Superba Cravats, Inc.</i> , 132 USPQ 699
IRON ACE IRON DUKE	work shirts trousers	<i>Day's Tailor Clothing Inc. v. Plymouth Dry Goods Corp.</i> , 132 USPQ 700
OLD SMOKEHOUSE THE OLD SMOKE HOUSE		<i>Ciraulo v. George A. Hormel &amp; Co.</i> , 132 USPQ 380

## POINT X.

### Appellant Is Not Entitled to Preliminary Injunction.

#### A. Plaintiff Has Not Shown Irreparable Injury.

In denying a motion for preliminary injunction, the Court, in *Avon Shoe Co. Inc. v. David Crystal, Inc.*, 100 USPQ 17 (D Ct SD NY) (1953), pointed out, at page 20:

“These questions may be resolved favorably for judicial protection *after trial*; they are by no means sufficiently free from doubt to justify disposition upon comparison of affidavit.

“There is finally no showing by plaintiffs that any damages which may be suffered before the case can be tried on its merits will be irreparable. No diversion of customers, no loss of trade and no surrender of a current specific opportunity \* \* \* is alleged and supported on this application. This, in addition, is reasonable ground for denial of the relief sought.”

Matters there referred to by the Court were stated as “These matters would have significant bearing on the proffered defense of laches.”

In *Allstate Ins. Co. v. Allstate Investment Corp.*, 136 USPQ 156 (1962), the Chief Judge pointed out, on judgment for defendant in an action for trademark infringement, at page 160:

“Plaintiff has been forced to admit that, notwithstanding its claim of ‘unfair competition’ by defendant, its insurance business has continued to spiral upward nationally \* \* \*.”



In *Nadys Inc. v. Majestic Metal Specialities, Inc.*, 104 USPQ 109 (1954) (D Ct SD NY), it was expressed: "Though plaintiff claims irreparable injury, no showing has been made beyond conclusory statements in an affidavit". That seems to apply to the case at bar, since even the affidavits are sparse even as to conclusory statements and as to all else.

In *Artype, Inc. v. Zapulla*, 104 USPQ 66 (D Ct SD NY (1954)), a complaint was dismissed in an action for trade mark infringement and unfair competition and injunction denied, the Court stating, at page 69:

*"It is true that a stronger prima facie case must be presented by an applicant seeking preliminary injunction in advance of trial than for similar relief after trial."* (Citing authority).

In *Lascoff v. Notkoff*, 105 USPQ 143 (1955) (NY Sup Ct NY), in refusing injunctive relief in an action for unfair competition, the Court pointed out: "Mere similarity of names, in and of itself, is not sufficient basis to afford plaintiff the injunctive relief it seeks".

In *Huber Baking Co. v. Stroehmann Bros. Co.*, 97 USPQ 409 (1953) (SD NY), the Court, in holding that where plaintiff's common law rights in mark and exclusiveness of mark were in doubt, stated, at page 411:

*"Even should the Court feel, from examination of the papers now before it on this motion, that plaintiff will ultimately prevail after trial of these issues, the fact that his right at this stage is clearly not beyond dispute is sufficient to deny the injunction pendente lite. (Citing authorities)."*

In *Tru Val Mfrs. Inc. v. Tru-Valu Corner, Inc.*, 106 USPQ (1955) (NY Sup Ct), the Court denied a preliminary injunction in a trademark infringement and unfair competition action, stating at page 161:

*“The interim relief prayed for is all that the plaintiff would be entitled to obtain, injunctively, were it to succeed upon the trial, and it has not been shown that the plaintiff will be irreparably harmed should it await such relief as may be granted after trial.”*

In *Triumph Hosiery Mills, Inc. v. Triumph International*, 126 USPQ 233 (D Ct. NY SD), a preliminary injunction was refused in an action for trademark infringement and unfair competition involving the corporate name. The Court pointed out, at page 236: “No evidence whatsoever has been presented which would even give rise to a suspicion that defendants are likely to engage in any practice that will adversely affect plaintiff’s reputation”.

In *Armed Forces Service Co. Inc. v. Pettee*, 107 USPQ 156 (1955), the Georgia Supreme Court, in a petition seeking to enjoin corporation from using corporate name in unfair competition, stated, the Presiding Justice writing the Opinion, at page 156:

*“The allegations of the petition simply amount to an allegation that he fears defendant corporation will injure him and his business. This court has many times held that the mere apprehension of injury is not grounds to enjoin the apprehended act \* \* \*.”*

In *Academy Award Products, Inc. v. Bulova Watch Co.*, 85 USPQ 310 (D CT NY), the court emphasized, at page 311:

“Plaintiff has not, for the purposes of this action at least, *clearly established its right to the exclusive use of the trade mark in question* and has not demonstrated that it is entitled to the drastic relief it seeks by way of preliminary injunction. \* \* \* It is well settled that the granting of a preliminary injunction is an exercise of far-reaching power to be indulged in only in cases *clearly demanding it*. (Citing authorities).”

The Second Circuit Court of Appeals, in *Societe Comptoir vs. Alexander's Department Stores*, 132 USPQ 475 (1962), in refusing a preliminary injunction in a trademark infringement and unfair competition action, pointed out that:

“*The courts have come to recognize the true nature of the consideration often involved in efforts to extend protection of common law trade names so as to create a shield against competition*. (Citing authority). *The interest of the consumer here in competitive prices \* \* \* is at least as great as the interest of plaintiffs in monopolizing the name.*”

**B. Laches, Acquiescence and Estoppel Bar Relief.**

The plaintiff's delay gives rise to a presumption that there is not that degree of urgency that would justify the issuance of a preliminary injunction. Defenses of laches, acquiescence and estoppel, present questions of fact which must be tried; such issues cannot be determined on affidavits on a motion for preliminary injunction.

In *Best Foods v. Hemphill Packing Co.*, 295 Fed. 425 (D Ct Del), the Court, in denying a preliminary injunction, pointed out, at pages 425-426:

“In the absence of justification the delay is more than sufficient to defeat plaintiff's motion for a preliminary injunction. \* \* \* Moreover, a preliminary injunction requiring defendant to cease using its *trade name*, its slogans, and carton *would have the effect of granting all the relief obtainable by a final decree.* \* \* \* The general purpose of a preliminary injunction is to maintain the *status quo*, and not to require the defendant to *make such changes in its affairs that, in the event it should succeed on final hearing, the injury caused to it by the temporary injunction would be irreparable.*

A preliminary injunction in the case at bar may well result in putting the defendant out of business. Thus the plaintiff would succeed in destroying competition even if it be ultimately determined at a trial that plaintiff was not entitled to the injunction.



## POINT XI.

### Appellant Has Not Sustained Its Burden of Proof.

#### The Authorities Relied on by Appellant Are Distinguishable.

The appellant relies on the case of *The Fleischmann Distilling Corp. v. Maier Brewing Company* (9th Cir.) 314 F. 2d 149, decided by this Court on February 12, 1963, on the question whether the name BLACK & WHITE on beer was likely to cause confusion of the mark on whiskey.

That case was decided one week *prior* to the case of *Plough, Inc. v. Kreis Laboratories*, No. 17719, *supra*, decided by the Ninth Circuit Court on *February 20th*, 1963, one week subsequent to that Court's decision, in the *Fleischmann* case, which reversed the District Court's decision, and held for defendant, as set forth in *Point VI, supra*, of Appellee's Brief.

In any event, the *Fleischmann* case is distinguishable from the case at bar, not only because that *Fleischmann* case involved a trademark which had a *secondary meaning* but also because a *preliminary* injunction was not involved. The decision there was rendered *after trial*.

It was even pointed out in the *Fleischmann* case, at page 18 of the decision, that "each case must stand on its own facts and prior decisions are of little assistance". The decision in the *Fleischmann* case held at pages 6-7 that the mark there involved was "assuredly a strong one", and "not a descriptive term, nor does it indicate anything that has the qualities of black and white" as applied to whiskey, and that the mark there "has no such connotation". The factual distinction of the case at bar, involving as it does de-



scriptive marks and not marks having a secondary meaning, makes the *Fleischmann* case inapplicable, in any event, irrespective of the more recent *Plough* case authority.

The Appellant relies also on the case of *National Lead Company v. Wolfe*, 223 F. 2d 1954 (9th Circuit) in support of its contention that third party registrations do not preclude plaintiff's rights to the trademark. That case does not stand for any such theory. The case dealt with the *publici juris* theory but did not pass upon the precise point as to whether a prior registration deprives a registrant of property rights in a trademark. No such point was raised in the case. In any event, that case did not involve a *preliminary* injunction. The case was tried. The third party registrations in that case were shown merely for the purpose of establishing the mark as a "weak" mark and that the term "Dutch" had become public juris. In that case intentional misleading was demonstrated. That case involved a fanciful word, not a descriptive term. The case has been distinguished in subsequent cases which held contrarily under the facts of such other cases.

No further attempt will be made to distinguish the specific cases cited by appellant, since a close examination of each discloses factual distinctions which make them inapplicable to the facts of the case at bar.

**Conclusion.**

It is, therefore, respectfully submitted, upon all of the foregoing that, both upon authority and reason, and upon the record herein, the Order of the District Court denying plaintiff's motion for a preliminary injunction, be affirmed, accordingly.

Respectfully submitted,

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*Attorneys for Defendant-Appellee.*

### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ADELE I. SPRINGER,



No. 18,629

IN THE

United States Court of Appeals  
For the Ninth Circuit

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DYMO INDUSTRIES, INC.,	}
<i>Plaintiff-Appellant,</i>	
vs.	
TAPEPRINTER, INC.,	
<i>Defendant-Appellee.</i>	

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PLAINTIFF-APPELLANT'S REPLY BRIEF

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No. 18,629

IN THE

**United States Court of Appeals  
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DYMO INDUSTRIES, INC.,  
*Plaintiff-Appellant,*

VS.

TAPEPRINTER, INC.,  
*Defendant-Appellee.*

PLAINTIFF-APPELLANT'S REPLY BRIEF



Appellant discusses the points which are raised in the Brief for Appellee in the order of their importance to the issues under review.

## A

The most important defensive issue questions the power of this Court to review the determinations of the court below. Appellee states, "Such finding of fact may not be disturbed on appeal." (Brief for Appellee, p. 11). But it fails to point up any "finding of fact" to support the argument. Appellee relies (Brief for Appellee, p. 11) upon the determination of the District Court "that there is great doubt as to whether or not the plaintiff has the exclusive right to use the word 'TAPEWRITER'." (R. 155). This is not a finding which resolves disputed facts, but is essentially one dealing with the effect of the transactions and events presented in the moving and opposition affidavits, to wit, the asserted third party uses and registrations. The true rule on appeal is, appellant submits, stated in *Sternot v. Norberg* (9 Cir. 1954), 210 F. 2d 615 at 619:

"\* \* \* When a finding is essentially one dealing with the effect of certain transactions or events, rather than a finding which resolves disputed facts, an appellate court is not bound by the rule that findings shall not be set aside, unless clearly erroneous, but is free to draw its own conclusions. \* \* \*" (Footnotes omitted)

The language to the apparent contrary that "essentially, the question is one of fact" (Brief for Appellee, p. 11), was not a holding of this Court in

*Miles Laboratories, Inc. v. Frolich* (9th Cir. 1961), 296 F. 2d 740, as appellee implies but was taken instead from *Miles Laboratories, Inc. v. Frolich* (S.D. Cal. 1961), 195 F. Supp. 256 at page 258. This statement should not be deemed controlling in view of this Court's later decision in *Fleischmann Distilling Corp. v. Maier Brewing Company* (9 Cir. 1963), 314 F. 2d 149 at 152:

“Numerous cases in this and other circuits hold that under the circumstances here present, the question of the likelihood of confusion is one for us to decide. In *Sleeper Lounge Company v. Bell Manufacturing Co.*, 9 Cir., 253 F. 2d 720, 723, this court quoted with approval the quotation in *Miles Shoes, Inc. v. R. H. Macy & Co.*, 2 Cir. 199 F. 2d 602, that ‘we are in as good a position as the trial judge to determine the probability of confusion.’

“One reason for applying the rule of that case and of the other cases in accord cited in the margin is that this determination of likelihood of confusion partakes more of the character of a conclusion of law than of a finding of fact. The inference to be drawn from the undisputed facts here are ‘derived from application of a legal standard.’ *Lundgren v. Freeman*, 9 Cir., 307 F. 2d 104, 115. Appellant asserts that this function of determining the likelihood of confusion is for us, and this has not been challenged by the appellees.” (Footnotes omitted)

This Court has also reversed the denial of a final injunction after full proof where the District Court has “applied an improper theory of law,” as in *Audio*

*Fidelity, Inc. v. High Fidelity Recordings, Inc.* (9 Cir. 1960), 283 F. 2d 551 at page 558. On this point it is significant, that appellee has not distinguished the authorities set forth at pages 7-10 of Plaintiff-Appellant's Opening Brief.

## B

The next most important point is the effect of appellant's registration. This Court, in the recent case of *Pacific Supply Cooperative v. Farmers Union Central Exchange Incorporated et al.* (9 Cir. 1963), ..... F. 2d ..... 17, 967, after stating the prior rule upon which appellee relies (Brief for Appellee, p. 14) and the changes made by the 1905 Act, stated the effect of the Lanham Act at pp. 20-21 of the slip opinion:

“\* \* \* in 1947 the Lanham Trade Mark Act became effective, after its adoption the previous year. Its purpose was not only to clear up inconsistencies and alleged ‘constructions’ of prior acts which ‘obscured and perverted’ their original purpose, but to simplify practices, carry out international commitments, and to create new substantive rights in registration, and thus create an incentive to registration.

\* \* \* \* \*

“For the first time registration of a mark gave *constructive notice to the world* of the registrant's claim of ownership (15 U.S.C. § 1072), including those previously relying on an intrastate use only. Not only did the registration establish prima facie evidence of ownership, but likewise prima facie evidence of validity of the registration and of the registrant's exclusive right to use. \* \* \*” (Footnotes omitted).



The “prima facie evidence” provided by U.S. Code Title 15, §§ 1057(b), 1115(a), places the burden of proof on the appellee. In *Aluminum Fab. Co. of Pittsburgh v. Season-All W. Corp.* (2 Cir. 1958), 259 F. 2d 314, the Court held, page 316:

“In the Lanham Act Congress made it clear that weight should be accorded to the actions of the Patent Office. The Act provided that ‘A certificate of registration of a mark \* \* \* shall be prima facie evidence of the validity of the registration \* \* \*.’ 15 U.S.C.A. § 1057(b). We are of the opinion that this means not only that the burden of going forward is upon the contestant of the registration but that there is a strong presumption of validity so that the party claiming invalidity has the burden of proof and in order to prevail it must put something more into the scales than the registrant. \* \* \*

“One of the purposes of the Lanham Act was to encourage registration of trademarks and other marks. Thus, among other things, that Act goes beyond all prior legislation in this field by providing, for the first time, that registration is prima facie evidence of validity.”

The real question on appeal arises as to whether the defenses upon which appellee relies are sufficient as a matter of law to overturn the statutory presumption.

## C

In its spearpoint on the merits, appellee has spared no effort. Appellee has combed the files of the Patent Office and has introduced several hundred trademarks (R. 90, 91, R. 115-132), for the most part to prove that the words “tape” and “write” and variations

thereof have been used by others in forming trademarks. If appellee had expended but a small proportion of that same effort in examining the files of the Patent Office to adopt an original mark *before* adopting a mark so close to that adopted and registered by appellant, the necessity for this trademark suit could have been obviated.

Appellee's primary reliance is placed on the trademarks set out in Exhibit A (R. 90, 91) of the affidavit of Benedict Bogeaus. None of the Patent Office registrations cited in this exhibit is for "Embossing Machines for embossing plastics, metals, and the like." (Specification of goods from appellant's registration. R. 90). The first and fourth registrations listed were both cancelled prior to the time appellant adopted its mark. The last Patent Office registration was adopted *after* appellant adopted its mark. The remaining registrations also cover diverse goods such as fountain pens, dental instruments, beverage dispensing parts and piece goods.

Since none of these registrations was ever used on the same goods as those of appellant, it follows as a matter of law that they do not in any way impeach appellant's ownership of its mark nor its exclusive right to use the mark on embossing machines. As this Court said in *Sunbeam Lighting Co. v. Sunbeam Corporation* (9 Cir. 1950), 183 F. 2d 969, at 972:

"\* \* \* The mere fact that one person has adopted and used a trade-mark on his goods does not prevent the adoption and use of the same or a similar trade-mark by others on articles of a different description.'"

The third party defense has been tried time and time again in this circuit and has been found wanting in *Fleischmann Distilling Corp. v. Maier Brewing Company* (9 Cir. 1963), 314 F. 2d 149; *National Van Lines v. Dean* (9 Cir. 1956), 237 F. 2d 688; *National Lead Company v. Wolfe* (9 Cir. 1955), 223 F. 2d 195; and *Del Monte Special Food Co. v. California Packing Corporation* (9 Cir. 1929), 34 F. 2d 774.

Appellee argues that neither *Fleischmann* nor *National Lead* involves a preliminary injunction (Brief for Appellee, pp. 64-65). Appellant submits that this distinction serves to strengthen, rather than to weaken, the authority of these two cases. In both *Fleischmann* and *National Lead*, the defendant was given an ample opportunity to prove up third party usages much more pertinent than those upon which defendant here relies. In each case, the proven fact of third party usages was considered by the trial court as justifying the conduct of the defendant. This Court, however, ruled that such facts, even if proved, did not justify an infringement of the plaintiff's mark and, in each case, reversed the trial court. Appellant submits, therefore, that the logical rule to be derived from these two cases is that they demonstrate that a trial on the merits of the defenses upon which the District Court here relied could avail the defendant nothing.

The Supreme Court authority which appellee cites does not detract from this well developed Ninth Circuit rule.

In *Ubeda v. Zialcita* (1913), 226 U. S. 452 (cited pages 16-17), the evidence conclusively established that

plaintiff had intentionally imitated a much earlier and widely known trademark for the identical goods which both plaintiff and defendant later manufactured. In other words, plaintiff had unclean hands in the true sense of that maxim. This case would be germane if the defendant here had shown that anyone had used the trademark here in question on tape embossing machines at the time plaintiff adopted its mark and that plaintiff had intentionally imitated that mark. Even with the myriad of alleged prior usages upon which appellee here relies, no pretense is made that such a situation is here existent.

In *Goodyear Co. v. Goodyear Rubber Co.* (1888), 128 U. S. 598 (cited pages 21-22), the court pointed out at page 602:

“\* \* \* But the name of ‘Goodyear Rubber Company’ is not one capable of exclusive appropriation. ‘Goodyear Rubber’ are terms descriptive of well-known classes of goods produced by the process known as Goodyear’s invention. Names which are thus descriptive of a class of goods cannot be exclusively appropriated by any one. \* \* \*”

In the case at bar on the other hand, the class of goods involved is known as tape embossing machines. The word “TAPEWRITER” and its synonym “TAPE-PRINTER” taken by themselves do not describe a tape embossing machine. Used by itself, neither name describes any known article. Neither word appears in the most complete dictionary. At most, the marks are suggestive, but then only after one has seen them used in connection with the specific articles.



The remaining cases on the third party defense either antedate The Lanham Act or are from remote jurisdictions. We submit that the rule applied in this circuit enunciates the principles applied in The Lanham Act more soundly than do any of the authorities upon which appellee relies. This circuit is not alone in its appraisal of the law. For example, the contention that because of prior use of the identical mark by a third party, the registrant did not have exclusive rights in the mark and could not enjoin its use was considered and overruled in *Aluminum Fab. Co. of Pittsburgh v. Season-All W. Corp.* (2d Cir. 1958), 259 F. 2d 314, with recognition of *Ubeda v. Zialcita* (1913), 226 U. S. 452 (259 F. 2d at page 317).

## D

Appellee also attacks appellant's trademark on the ground that it is descriptive, but as we have pointed out two paragraphs above the goods are described as tape embossing machines. In addition, the experts in the Patent Office have already decided this question in favor of the mark. Appellee, in adopting its own trademark "TAPEPRINTER" proclaimed it to be a trademark (R. 17, 19).

The argument of an appellee who refers to "appellee's mark, 'TapePrinter'" and "appellant's purported trademark, 'TAPEWRITER'" (Brief for Appellee, p. 1), that one mark is a trademark and that the other is descriptive should not be given undue weight. We submit that appellee's admissions as to



trademark significance are a truer test than its strained arguments made solely for the benefit of securing a favorable decision in litigation.

The presumption of validity provided by the statute extends to descriptiveness. This is brought out in *Aluminum Fab. Co. of Pittsburgh v. Season-All W. Corp.* (2 Cir. 1958), 259 F. 2d 314, where the court held:

“\* \* \* In a case such as this, where it can be argued with equal force that a mark is descriptive and on the contrary that it is arbitrary and fanciful, the courts should not overrule the action of the Patent Office to whose care Congress has entrusted the preliminary determination as to whether a mark fulfills the requirements of the statute.” (p. 316)

\* \* \* \* \*

“The law reports are full of cases which counsel can cite on both sides of the question of whether a trademark is descriptive within the meaning of the Act. See cases cited in 87 C.J.S. Trade-Marks, Etc. § 33, pp. 267-272, and particularly *Gold Seal Company v. Weeks*, D.C. 1955, 129 F. Supp. 928, 929, 934, affirmed *sub nom.* *S. C. Johnson & Sons Inc., v. Gold Seal Co.*, 1956, 97 U.S. App. D.C. 282, 230 F. 2d 832. It may well be that the many differing and irreconcilable views of the courts was one of the reasons which impelled Congress to write into the 1946 Act the presumption of validity from registration. At any rate nothing could be clearer than the fact that prior decisions were of little help, and that there was a need to give to the imprimatur of the Patent Office some real value.” (p. 317)

## E

Appellee further urges that there is no confusing similarity between "TAPEWRITER" and "TAPE-PRINTER". When the applicable legal criteria set forth in Restatement of the Law, Torts, vol. 3, § 729, pp. 592-593, are applied to the marks in question, it is plain that appellee's trademark "TAPE-PRINTER" is confusingly similar to appellant's registered trademark "TAPEWRITER."

It is undeniable that the meaning of the two marks is substantially identical in that each suggests the placing of indicia on tape in a fanciful manner which is not actually practiced by either party. Whereas both emboss neither so states.

The appearance of the two marks are almost identical. Both begin with the word "Tape" and both end with the identical syllable "ter." Both marks have an "ri" letter combination in the middle of the mark. Indeed, all that need be done to convert appellee's trademark to that of the appellant is to change the letter "p" to the letter "w" and to drop the letter "n".

And the same situation is presented with respect to the sounds of the two trademarks. Both marks are accented on the first syllable and this syllable is identical in both. In addition, the next most prominent syllable, namely the last syllable, is again identical. If the two marks are said aloud, they can be distinguished only with close attention.

Under the circumstances, the similarities between the two marks are much more pronounced than were

the similarities between the two marks involved in *G. D. Searle & Co. v. Chas. Pfizer & Co.* (7 Cir. 1959), 265 F. 2d 385, wherein the Court of Appeals, in reversing the District Court, found that the trademark “Bonamine” was confusingly similar to “Dramamine.” At page 387, the court said:

“That part of the finding which states Dramamine and Bonamine are unlike is clearly erroneous. Dramamine and Bonamine contain the same number of syllables; they have the same stress pattern, with primary accent on the first syllable and secondary accent on the third; the last two syllables of Dramamine and Bonamine are identical. The initial sounds of Dramamine and Bonamine (‘d’ and ‘b’) are both what are known as ‘voiced plosives’ and are acoustically similar; the consonants ‘m’ and ‘n’ are nasal sounds and are acoustically similar. The only dissimilar sound in the two trademarks is the ‘r’ in Dramamine. Slight differences in the sound of similar trademarks will not protect the infringer. *Lambert Pharmacal Co. v. Bolton Chemical Corp.*, 2 Cir., 219 F. 325, 326.”

Concurrent use of appellant’s mark “TAPEWRITER” and the appellee’s mark “TAPEPRINTER” on identical goods moving through the same channels of trade and the same retail outlets can do nothing but create confusion in the minds of the purchasing public.

## F

Appellee contends that appellant’s use of the mark “DYMO” with its mark “TAPEWRITER” prevents

the latter mark from serving as a source of origin (Brief for Appellee, pp. 25-28). The argument lacks substance. It is like arguing that Ford cannot protect Falcon because sometimes Ford advertises the Ford Falcon.

The argument lacks factual substance. This contention is based on a truncated view of the record. Reference to typical examples of appellant's advertising in the record shows that the mark "TAPEWRITER" is frequently used alone and is consistently given as much prominence as the mark "DYMO," when the marks are used together. Thus in Exhibit A attached to the Complaint (R. 11), "TAPEWRITER" appears alone just above the upper illustration of the device and is followed by the trademark registered symbol ®. In Exhibit B attached to the Complaint (R. 12), the mark is used alone in the text, the mark being printed in conspicuously larger type than that used for the text and with an asterisk behind it to indicate that it is a trademark of Dymo Industries, Inc. The legend "\*TRADEMARK DYMO INDUSTRIES INC." appears just above the top illustration. Whenever the mark "TAPEWRITER" is used in this exhibit with other trademarks of the appellant it is given equal prominence. Again in Exhibit C attached to the Complaint (R. 13), the mark is given the same prominence as the mark "DYMO" and is followed with the trademark registered symbol ®. In Exhibit D (R. 14), the mark is used alone in the "A MESSAGE FROM THE MAKERS" text and in the "DO'S AND DON'TS" box. "TAPEWRITER", again with



the registration symbol ®, is used alone on the back of Exhibit E (R. 15), and is either given the same prominence as is shown by the back page of the exhibit or *greater* prominence as is shown by the front page.

In the face of this record evidence, it is manifestly clear that appellee's statements that appellant is using the registration symbol after "DYMO" and not after "TAPEWRITER" and that "DYMO" is appellant's primary trademark and not "TAPEWRITER" are de hors the record.

Appellee cites *Kellogg Co. v. Nat. Biscuit Co.* (1938), 305 U. S. 111 (Brief for Appellee, page 27). There, in deciding that the defendant did not infringe plaintiff's mark, the court pointed out that the defendant did not use the registered trademark by itself, but only used the mark in conjunction with its own very well-known trademark "Kellogg". The facts of the *Kellogg* case, however, are very different from the facts of the case at bar. In the case at bar, the trade name of appellee is itself confusingly similar to appellant's mark. Its inclusion on the package serves to compound the confusion, not to minimize it. That case actually turned upon the well established right of the public to use the designation "shredded wheat" on a patented product after the expiration of the patent. The court held that there could be no secondary meaning because the popularity of the designation arose as a consequence of the patent monopoly. Here the trademark "TAPEWRITER" was not even adopted until after the expiration of the



basic Zipf and Payne embossing machine patents set forth in paragraph 6 of the opposition affidavit of Daniel T. Anderson (R. 33).

But in any event the law is clear that a trademark proprietor may use several marks in connection with the sale of his merchandise and that each of the marks is protectable [*General Shoe Corporation v. Rosen* (4 Cir. 1940), 111 F. 2d 95]. There the court said at page 99:

“Our conclusion is that the term ‘Friendly’ as applied to shoes, is a valid trade mark entitling the owner to the protection of the court; and it is not invalidated by the fact that in many instances, perhaps the majority, it has been used by the plaintiff on its goods and in its advertising matter in connection with its trade mark ‘Jarman’. More than one trade mark may be used by the owner upon his wares without invalidating either. \* \* \*”

And in *Fleischmann Distilling Corp. v. Maier Brewing Company* (9 Cir. 1963), 314 F. 2d 149, this Court had a similar contention before it. There, at page 161, the Court said:

“We notice one conclusion of the district court (No. 13), which can have no bearing upon the decision of this case. That conclusion reads as follows: ‘13. The defendants, by using the name “Black & White” on beer, have not infringed the plaintiffs’ trademark rights in plaintiffs’ combination mark of the words “Black & White” and two Scottie dogs.’ The facts are that Buchanan has two federal trademarks;—one is the Black & White mark which we have previously discussed,

and the other, which it registered at a later date, consisted of the combination of the words 'Black & White' and a picture of a pair of Scottie dogs, one of them black and one of them white. The evidence shows that Buchanan had used both trade-marks on this whisky. The first one, 'Black & White' appears on the label on the front of the bottle; the combination trademark,—the Scottie dogs combined with the words Black & White,—appear on the label on the back of the bottle. This action was brought for infringement of the first trademark using the words Black & White alone. It is not alleged that the other trademark was infringed by the defendants and the fact that the Scottie dogs do not appear on defendants' beer is immaterial and irrelevant. Conclusion No. 13 is also irrelevant."

## G

Appellee contends that appellant has unclean hands because of alleged misuse of the symbol ® in connection with the trademark "DYMO" (Brief for Appellee, pp. 9, 29-31). At the outset, appellant urges that its use of the trademark "DYMO" is immaterial in the issues at bar. Relief is here sought, not for infringement of that mark, but for infringement of the trademark "TAPEWRITER". There is not even a pretense that there has been any misuse of the trademark symbol with regard to the mark in suit.

However, even if the issue were germane, there are no false representations in the case at bar. Here appellant did in fact own a registration on the mark "DYMO" (R. 142). On various advertisements, ap-

pellant did sometimes place the symbol ® after the trademark "DYMO" even when the advertisement in which the symbol was used was directed to embossing machines. The mere fact that the registration certificate itself specifies a line of goods which does not recite embossing machines does not rob the mark of its registered status. Here the advertisement is true, not false. The notice designation is a truthful statement of the fact of registration which gives notice to the public that the mark is registered. It protects the public from inadvertent use of the mark even though from a hypertechnical standpoint, the registration certificate does not recite the specific goods in question. There is no suggestion in the record that the symbol was used with the intent to deceive any member of the public.

The three cases which appellee cites on the proposition do not even touch upon the question here at bar. Their generalized statements refer to statements which are false and which were knowingly made. In the case at bar on the other hand, the symbol ® is permitted by statute to designate a registered trademark (U. S. Code, Title 15, § 1111). Nothing in the statute limits the right to give statutory notice because of the classification of goods recited in the certificate. Appellee actually asks this Court to write a limitation into the statute which the Congress did not see fit to impose.

Appellant submits that the unclean hands defense should be stricken. The District Court gave it no weight. Appellee should not resurrect it here.

## H

Appellee's Point XA that appellant is not entitled to a preliminary injunction because it has not shown irreparable injury (Brief for Appellee, pages 59-62) is without substance. Appellee has a capitalization of only \$25,000 (Plaintiff-Appellant's Opening Brief, page 5). If it is permitted to continue to use the mark "TAPEPRINTER" in competition with "TAPEWRITER", appellee may completely destroy the mark itself and destroy the good will which appellant has given the mark. With a capitalization of \$25,000 and an accumulated indebtedness of \$350,000, appellee can not respond in damages if appellant is successful. On the other hand, the bond required for a preliminary injunction will protect appellee in the event the injunction should later prove to be improper for any reason. The amount of damages to appellee are bound to be small. The substitution of a non-confusing trademark for the mark "TAPE-PRINTER" contemplates nothing more than the printing of new literature and packaging, the correction of a die, and the adoption of a new corporate name and trademark. If there ever was a case where the equities cry out for the issuance of a preliminary injunction, this is that case.

## I

Appellee's Point XB is that appellant is not entitled to a preliminary injunction because of laches, acquiescence and estoppel (Brief for Appellee, page 63). Appellee points to no facts creating laches and



estoppel. The undisputed facts in this case are that appellee is a new-comer in this business and that suit was filed promptly after the appellee placed its product upon the market (Affidavit of Leo B. Helzel, R. 23-24, also Affidavit of Benedict Bogaous, p. 3, R. 78). Moreover, even if laches were present that would not bar injunctive relief [*Safeway Stores v. Dunnell* (9 Cir. 1949), 172 F. 2d 649].

## J

Appellee's final Point XI is to the effect that appellant has not sustained its burden of proof because its authorities are distinguishable (Brief for Appellee, pages 64 and 65). Although appellant cited only 11 cases, appellee responds only to *Fleischmann Distilling Corp. v. Maier Brewing Company* (9 Cir. 1963), 314 F. 2d 149, which is cited at page 16 of the opening brief and *National Lead Company v. Wolfe* (9 Cir. 1955), 223 F. 2d 195 which is cited at pages 6 and 11 of the opening brief.

We have argued above that appellee's distinctions of the *Fleischmann* and *National Lead* are unsound (this brief, page 6).

In discussing *Fleischmann* and *National Lead*, appellee also finds it significant that this Court subsequently held for defendant in *Plough, Inc. v. Kreis Laboratories* (9 Cir. 1963), 314 F. 2d 635 (Brief for Appellee, page 64, see also pages 31 and 35). There is no parallel between *Plough* and the case at bar. In *Plough*, plaintiff used the trademark "Coppertone" and defendant used the trademarks "Coca Tan" and



“Coca Tint”. The opposing marks are dissimilar both in sound and in connotation. Clearly no confusion could arise in the market place. The dispute arose, not in the market place, but out of an earlier adjudication in which, by consent, the defendant was prohibited from using a series of marks including the syllable “copa” which is, of course, similar in sound and connotation to “copper”. The *Plough* case is a split decision which appellee should not seek to expand beyond the facts there adjudicated.

## K

Appellee’s survey presented under Point IX of its brief (Brief for Appellee, pp. 51-58) has no relevancy to this case. Only the marks in question are given in every instance. In many cases, such an important fact as the goods involved is not even recorded (Brief for Appellee, pp. 55-58). Manifestly many other important facts bearing on the outcome of each case, such as the channels of trade, the intent of the defendant in adopting the mark, etc., are also omitted. Under these circumstances such a list is of no help to the Court in passing on the issue here. As this Court recently observed in the *Fleischmann Distilling Corp. v. Maier Brewing Company* (9 Cir. 1963), 314 F. 2d 149 at page 160:

“\* \* \* It is elementary that in the decision of a case of this kind, involving the question of confusing similarity, each case must stand on its own facts, and prior decisions are of little assistance. \* \* \*” (Footnote omitted).

For the reasons stated appellant urges that the order of the District Court be reversed and that it have the relief prayed for in the conclusion of the opening brief, page 18.

Dated, San Francisco, California,  
August 28, 1963.

Respectfully submitted,  
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### CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

CARL HOPPE,

*One of the Attorneys for Plaintiff-Appellant.*



No. 18630

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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UNITED STATES OF AMERICA,

*Appellant,*

*vs.*

V-R RANCH COMPANY, a corporation,

*Appellee.*

---

Appeal From the United States District Court for the  
Southern District of California, Central Division.

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Answering Brief of V-R Ranch Company, a Corporation, Appellee, to Brief of the United States, Appellant.

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**FILED**

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---

Answering Brief of V-R Ranch Company, a Corporation, Appellee, to Brief of the United States, Appellant.

---

**Preliminary Statement.**

The Appellant, United States, has filed one brief in its appeal from four separate judgments in condemnation. In this brief the Government assumes that the same facts found, legal conclusions, evidence, and testimony are involved in all four cases. This assumption is untrue so far, at least, as Appellee V-R Ranch Company is concerned. The V-R Ranch Company case was a separate trial involving different problems, different types of property, and, in many respects, different testimony than that involved in the other cases. We find it extremely difficult and burdensome to attempt to answer the Government's brief, and at the

same time, to refrain from commenting upon evidence introduced in the other three cases, to which the Government refers. We assume that the Appellants in the other three cases will file separate briefs for each case and the Appellee V-R Ranch Company will respond to the Government's brief only so far as it applies to the case of the *United States of America*, Appellant vs. *V-R Ranch Company*, No. 18630. We will not attempt to answer those portions of the Government's brief which deal with the other three cases because we are not familiar, except in a general way, with the trial of these actions, we do not have the records of transcripts of these cases, and we must assume that the attorneys representing the other appellees will fully and adequately answer those portions of the Government's single brief, if they can separate them out, that apply to each of the other cases. We cannot refrain from commenting, however, that we feel that the Government is entirely unjustified in filing but one brief in which the evidence apparently introduced in one case is cited and argued as if it effects the other cases. We feel that the Government has placed an unnecessary and burdensome task upon both court and counsel in not filing separate briefs on each case.

### **Statement of the Case.**

The *V-R Ranch Company* case was filed August 12, 1957 [R. 9]. The hearings thereon commenced before a commission of three persons, appointed under Rule 71A(h) of the Federal Rules of Civil Procedure, consisting of Welburn Mayock, Chairman, Francis C. Whelan and Virgil F. Frizzell, Commissioners, on July 25, 1960, for the viewing of the *V-R Ranch Company* property by the commission. The viewing was com-

pleted on July 27, 1960 [R. 9]. Although it does not appear in the *V-R Ranch Company* record, the previous viewing of the general area of the properties in this project and all of the sales of both the Government and the land owners took place starting on December 14, 1959, in the *Benning* and *Dunshee* cases [*Benning*, Tr. 1-360], under a stipulation entered into that record that the general viewing of the area of the subject properties and of the comparable sales of both parties might be considered in relation to the subsequent trial of the *V-R Ranch Company* case [*Benning*, Tr. 9, lines 15-24]. Hearings on the *Benning* and *Dunshee* cases were commenced, before the same commission that subsequently heard the *V-R Ranch Company* case, on December 14, 1959, and continued to June 30, 1960. Hearings in the *V-R Ranch Company* case commenced July 25, 1960, and were concluded on December 5, 1960 [R. 9]. The complete report of the Commission is set forth in the record [R. 9-53]. *V-R Ranch Company* moved to confirm the report on March 23, 1961 [R. 53-54] and the Government filed objections thereto on April 7, 1961 [R. 76]. These objections by the Government to the commission's report in the *V-R Ranch Company* case are set forth in full in the *V-R Ranch Company* transcript [R. 62-77]. The District Court held its hearing *on these objections* on May 2, 1961, and on May 16, 1961, the District Court made its order whereby the said commission's report was "confirmed, approved and adopted in all respects" [R. 79]. The judgment was entered thereon on May 16, 1961 [R. 90]. The *V-R Ranch Company* judgment was reversed by this Court in July, 1961, on the sole ground that the District Judge erred in overruling

the objections of the Government in approving the report without awaiting a transcript of the testimony (See *United States v. Lewis* [9 Cir. 1962] 308 F. 2d 453), and remanded with instructions that the judgment be set aside and further hearings be conducted “upon the objections of the United States, as hereinbefore filed” (*United States v. Lewis*, 308 F. 2d 453 and 462). A consolidated hearing was had on September 25, 1962, on the *Benning*, *Dunshee*, and *V-R Ranch Company* cases [V-R Ranch Supp. R. 40]. At this consolidated hearing, the Government again presented and argued its objections heretofore filed, with the exception that objections numbered 2, 4, and 5 [R. 62-63], based upon the alleged inadequacy of the reports, were not argued again to the District Court, since this issue had been decided adversely to the Government’s position in the previous appeal (*United States v. Lewis*, 308 F. 2d 453, 460 to 462). After this consolidated hearing with the benefit of the respective transcripts of testimony before him, and after complete argument and examination of the transcripts of testimony, the District Judge again approved and adopted the commission’s report, and entered judgment, and these appeals followed. The consolidated hearing upon the objections (other than those dealing with the inadequacy of the reports) was heard upon the transcripts of testimony and in light of this Court’s injunction that:

“It is the function of the District Court to review the Commission’s Report and findings *in the light of objections made to it and to resolve the issues presented by such objections.*” (*United States v. Lewis*, 308 F. 2d 453, 460 - italics added).



The issues presented by these objections [R. 62-77] (except those dealing with the inadequacy of the reports already decided on the prior appeal and properly not reargued in the second hearing) were resolved by the District Court. The issue on this appeal is whether or not the District Court committed error in resolving *the issues presented by these objections*, and we believe this is the only issue properly before this Court on this appeal, but for some reason, which the writer of this brief cannot fathom, the Government has apparently now abandoned these objections—except, strangely enough—the ones dealing with the adequacy of the report, which has already been resolved by this Court on its previous appeal. The Government apparently seeks to appeal not the District Judge's action in resolving the issues presented by these objections, but seeks to have this Court review the commission's action, raising, in addition to their contentions regarding the adequacy of the reports (Government Questions 1 and 2) two new questions set forth in their brief, page 3, as follows:

“3. Whether the facts disclosed by the findings supplemented by undisputed facts in the records show that the awards are excessive and do not represent fair market price at the dates of taking.

“4. Whether the awards by the commissions are clearly erroneous because not supported by actual facts in the records and because based on erroneous principles of valuation.”

As we shall point out hereafter in this brief, these two new questions were not even presented to the District Judge. The single possible exception is the Government's objection No. 1 [R. 62] that the award is excessive and not supported by the evidence which is



couched in such general terms as to be completely meaningless and which was not supported before the District Judge by reference to the transcripts, which the Government on the previous appeal had insisted were necessary for the District Judge to resolve the issues raised by the objections heretofore filed.

The fact is that, none of the issues raised in this appeal were presented to the District Court for ruling as “issues presented by such objections.” In this connection, the Government, in the case of *United States v. Twin City Power Company* (4 Cir. 1957), 248 F. 2d 108, took the position that the trial judge in that case had erred in setting aside the commission’s findings because there was substantial testimony supporting the findings of the commission, and because the commission saw and heard the witnesses. In that case, it was held that the Court of Appeals reviews the actions of the District Judge and not the commission, saying on page 112 (248 F. 2d):

“[2-4] We review the District judge, not the Commission.”

In the instant case, the Government is seeking to have this Court review the action of the commission in light of the record, and we do not believe that the issues raised by the Government’s arguments I, II, III and IV are properly before this Court. We will nonetheless, lest it be contended that by our silence we admit the contentions, answer these arguments separately hereafter.

Before answering the Government’s Arguments I, II, III and IV, we will comment upon some of the Government’s contentions set forth under the designation in their brief of “Proceedings Below”.

### Comment on Government's Statements in Portion of Government Brief "Proceedings Below".

On Page 5 of their brief, the Government sets forth what they refer to as "undisputed" physical facts, apparently taking these facts from the *Benning* case. We do not have access to either the report or the transcript of testimony in *Benning*. The facts stated seem accurate *so far as they go* but they leave out many important and undisputed physical facts. We respectfully direct the Court's attention to the facts set forth in Findings 4 and 5 [R. 12-20], Finding 8 [R. 21-22], Finding 9 [R. 23-24], Finding 10 [R. 24-30], Finding 11 [R. 30-32], Finding 12 [R. 32-33] and Finding 13 [R. 34-35]. We believe that these *undisputed* facts are much more complete and comprehensive than those few selected physical facts cited by the Government in its brief. Although one of the primary points of dispute between the parties was the amount of water available to *V-R Ranch* property, all the Government says about this matter in its entire brief is that:

"Also, findings were made at some length concerning water facilities available [R. 29-32]." (Govt. Br. p. 7).

The findings regarding the water resources available to the *V-R Ranch* property are set forth in detail in Finding 11 [R. 30-32], Finding 12 [R. 32-34] and Finding 14 [R. 35], to which the Court's attention is respectfully directed and which we will not repeat herein. The Government witnesses in expressing their opinions of highest and best use, value and comparable sales, *assumed* that the V-R property did not have sufficient water to support any subdivision development. [For example, see *Sando*: Tr. 3530 and 3795]. The

landowners' appraisers based their opinions of highest and best use, value and comparable sales on the assumption that there was sufficient water available for the purposes they opined upon.

In the *V-R Ranch* case above the water testimony covered 2429 pages of testimony and 146 exhibits (See page 48 of this brief and Appendices "E" and "F" to this brief) and the commission after detailed findings of the water resources available to *V-R Ranch Co.* properties, specifically found as follows:

"The Commissioners further find that the aforesaid water resources, assuming maximum development as aforesaid, provide for the development of said property to the uses and purposes hereinafter in these findings set forth." [R. 32].

This finding is undisputed *on this appeal* although 8 of the 34 objections hereinbefore filed and resolved by the district judge concerned water findings (These objections are objections numbers 13, 14, 15, 16, 17, 18, 19 and 20 [R. 66-76]). Thus if we are to disregard objections 1, 2, 3, 4, 5, 32, 33 and 34 as too vague and general to constitute objections calling for the resolution as this Court stated on the previous appeal, of "some specific dispute" or some "specific inadequacy", it will be seen that of the remaining 26 specific objections, no less than 8 thereof dealt with the finding regarding water resources available to *V-R Ranch Co.* property. It can be thus seen that without considering water resources available to *V-R Ranch* property as compared with the water resources available to the so-called comparable sales (to say nothing of the varying topographies, sizes, locations, environmental factors, climates, etc. etc.) it is impossible to try to

have this Court determine which sales were and which were not sufficiently alike to be some reasonable index of value.

Continuing our comment on statements made in the Government brief under the title “Proceedings Below”, the Government states on page 10 of its brief:

“The Government’s experts relied upon some 28 sales in Santa Ana and Coyote Creek Valley and the neighboring Ojai Valley . . . and others being from about one and a half miles from the land in question.”

And again on page 11 of its brief, that:

“They [the landowners experts] ignored all the sales relied upon by the government witnesses.”

This latter statement is without support in the record, and the Government cannot point to one substantiating fact for this statement. We do not know about the other cases but in the *V-R Ranch* case the government witnesses relied upon 33 sales [set forth in Pltf. Ex. 3—Tr. 2128], 8 of which are located in Conejo Valley, the area to which the Government *now* objects. We will discuss this matter of comparable sales later in this brief, but at this stage we would like to point out that of the 28 sales which the Government says, without any foundation in the record or the transcript, that the landowners experts “ignored” (Govt. Br. p. 11) (not to be confused with the later contention in Argument III(B) (Govt. Br. p. 40) that the *commission* ignored these 28 sales), 8 of them are the identical sales used and relied upon by the landowners experts. These sales which are identical sales are as follows:



Govt. Sale 1	=	Defts. Sale 25-1 [Benning Tr. 126-130]
Govt. Sale 2	=	Defts. Sale 24-1 [Benning Tr. 120-123]
Govt. Sale 5	=	Defts. Sale 23-2 [Benning Tr. 203-211]
Govt. Sale 16	=	Defts. Sale 23-5 [Benning Tr. 269-277]
(Govt. Sale 31)	=	Defts. Sale 23-6 [Benning Tr. 244-277]
(Govt. Sale 32)	=	
Govt. Sale 41	=	Defts. Sale 23-3 [Benning Tr. 235-244]
Govt. Sale 45	=	Defts. Sale 22-2 [Benning Tr. 277-284]
Govt. Sale 46	=	Defts. Sale 22-1 [Benning Tr. 286-294]

How can the Government make the bald statement that they (the landowners' experts) ignored all the sales relied upon by the government witnesses when 8 of the 28 sales listed in Appendix "B" to the Government Brief are identical with those used by the landowners experts. The Government continues (Govt. Br. p. 11):

"Instead, they said that the Conejo Valley—  
was an appropriate area to find comparable sales."

The clear inference from this statement is that only the landowners' witnesses used Conejo Valley sales. This, of course, is not true. The Court's attention is called to the fact that the landowners' experts used, to varying degrees, "Conejo Sales", which are in the 19 series—19-1 to 19-11 [Deft. Ex. "V," Tr. 66]. An examination of Plaintiff's Exhibit 47, Appendix "A" to this brief [Tr. 3572], the Summary and Classification of Acreage Sales, illustrative of the testimony of Laurence Sando, government appraiser, shows that 8 of the sales relied upon are Conejo Valley sales, the area to which the Government *now*, for the first time objects. For the convenience of this Court we attach a copy of Plaintiff's Exhibit 47 to this brief as Appendix "A". These 8 "Conejo Valley" sales are listed



on the third page of Plaintiff's Exhibit 47 [Tr. 3572] as "Summary and Classification of Acreage Sales in Conejo Valley" and are Government sales Nos. 51 through 58. Of these 8 Conejo Valley sales ("illustrative of the testimony of Laurence Sando"), 6 of them are the same sales as used by the *V-R Ranch* appraisers, Mr. Mann and Mr. Jerry Carll. These duplicate Conejo Valley sales are as follows:

Plaintiffs Sale No.	Defendant's Sale No.
51	19-9 [Benning Tr. 326, line 12, to 329, line 7].
52	19-10 [Benning Tr. 331 line 24, to 338, line 14].
53	19-6 [Benning Tr. 331, line 14, to 332, line 13].
54	19-2 [Benning Tr. 338].
55	19-3 [Benning Tr. 329, line 9, to 331, line 13].
56	19-8 [Benning Tr. 329].

We are unable to understand how the Government can say that the landowners' experts ignored *all* of the sales relied upon by the government witnesses when, of the 33 sales relied on by the government experts, 15 of the landowners' sales are exact duplicates of their sales, and which were brought into the case by the landowners' witnesses before the government witnesses even testified.

As a matter of fact the Government had a list of 34 sales [See Pltf. Ex. 3—Tr. 2128] and their witness Mr. Evans used 23 sales on his "Comparable Sales Pattern" [Pltf. Ex. 9—Tr. 2395] and Mr. Sando used 33 sales on his "Summary and Classification of Acreage Sales" [Pltf. Ex. 47—Appendix "A"—Tr. 3572].

The landowners' sales are listed on Defendant's Ex. "V" [Tr. 66].

The list of sales purportedly used by the landowners' appraisers in Appendix "C" to the Government brief is incomplete so far as *V-R Ranch* case is concerned. In addition to the sales there listed, the *V-R Ranch* appraisers also used 10 additional sales not listed on Appendix "C" to Government brief. These sales are 20-1, 20-2, 20-3, 20-4, 22-1, 22-2, 23-2, 23-5, 24-1, 25-1 [See Deft. Ex. "V"—list of comparable sales in evidence *by stipulation*—Tr. 66].

Appendix "B" to the Government brief is likewise incomplete since the government appraisers used 9 additional sales which are not listed in said Appendix "B". These are Sales Nos. 50A, 51, 52, 53, 54, 55, 56, 57 and 58 [See Pltf. Ex. 3—Tr. 2128 and Pltf. Ex. 47 Tr. 3572—Appendix "A" to this brief].

Furthermore the Commissioners viewed all of the sales, examined them very carefully [See Benning Tr. 126-329], had them discussed and analyzed by the witnesses, with topographic maps, photographs and detailed analysis. Defendant's 11 "Conejo" sales (19-1 to 19-11) were described in detail by the appraisers George S. Mann [Tr. 1273-1344] and Jerry Carll, Sr. [Tr. 1781-1840].

As for the Conejo Valley sales (Sales 19-1 through 19-11), the *V-R Ranch* appraisers used them to a limited degree (as discussed more fully in the brief hereafter), whereas the government appraiser, Mr. Sando used 8 "Conejo" sales (Sales No. 51 through 58) and of these 8 Conejo Sales, 6 were duplicates of the sales used by the *V-R Ranch* appraisers [See and compare Pltf. Ex. 3—Tr. 2128; Pltf. Ex. 47—Appendix "A" to this brief—Tr. 3572; Deft. Ex. "3D"—Tr. 1265 and Deft. Ex. "3F"—Appendix "B" to this brief—Tr. 1684].

Again commenting on the Government's statement on page 11 of its Brief, that: "They [the landowners' experts] ignored *all* of the sales relied upon by the Government witnesses. Instead, they said that the Conejo Valley . . . was an appropriate area to find comparable sales," we wish to point out that not only did all of the appraiser witnesses use "Conejo" sales, to some extent, but the *inference* implied in the above sentence that the landowners' experts relied only on "Conejo" sales is completely false.

For the convenience of this Court, and because we will be referring to it from time to time, we attach a copy of Defts. Ex. "3F" [Tr. 1684] as Appendix "B" to this brief.

Take for example *V-R Ranch* appraiser, Jerry B. Carll, Sr., whose land classifications were followed more closely than those of the other witnesses [compare Finding 10—R. 24-30 with Deft. Ex. "3F", Tr. 1684] and referring to said Appendix "B", it can be seen that Mr. Carll utilized 19 sales over all and of these sales only 6 are "*Conejo*" sales [See second page of Deft. Ex. "3F"—Tr. 1684, Appendix "B"]. These 6 sales are as follows: 19-6; 19-7; 19-8; 19-9 and 19-11. Of these six "*Conejo*" sales used by Mr. Carll, four of them are also government sales, as follows: 19-6 = Govt. No. 33; 19-8 = Govt. No. 56; 19-9 = Govt. No. 51 and 19-10 = Govt. No. 52.

Furthermore on his classification No. 1—prime subdivision land [Deft. Ex. "3F"—Tr. 1684, Appendix "B"], adopted by the Commission as the *only* land (321.03 acres) with the highest and best use for the development and use as residential subdivision [See

Finding 18(a)—R. 43], Mr. Carll did not use or rely upon a single “*Conejo*” sale. He used our sale 22-1 [Govt. sale 46—*Benning*, Tr. 286-294], sale 23-5 [Govt. sale 16—*Benning*, Tr. 296, lines 269 to 277], sale SB 1 and sale SB 2. The sales Mr. Carll used are set forth on Defendant’s Exhibit “3F”—Mr. Carll’s opinion chart [Tr. 1684—Appendix “B”].

On Mr. Carll’s classification No. 2—154.26 acres (adopted by Commission as its *classification* No. 2 [R. 26],) the Commission found a highest and best use not as subdivision but for development as rural home-sites [See Finding 18(b)—R. 43]. An examination of Appendix “B” [Deft. Ex. “3F”] shows that Mr. Carll used and relied on 5 sales [listed on said Ex. “3F”] and only 3 of these 5 sales are “*Conejo*” sales—these “*Conejo*” sales are: Sale 19-7; 19-8 [Govt. sale 56—See *Benning*, Tr. 329]; 19-10 [Govt. Sale 52—See *Benning*, Tr. 331, line 24, to 338, line 14]. The other two sales used and relied upon by Mr. Carll on his classification 2, was sale 22-2 [Govt. sale 45—See *Benning*, Tr. 277, lines 1-284] and sale SB 2, which “they [the government witnesses] ignored.”

[See and compare “Summary and Classification of Acreage Sales”, illustrative of testimony of Laurence Sando—Pltf. Ex. 47—Appendix “A”; Pltf. Ex. 3 “List of Comparable Sales”—Tr. 2128 and “Chart No. 1—Opinion of Value of Whole” (1594.2 AC) by Jerry B. Carll, Sr.—2d page of Deft. Ex. “3F”—Appendix “B”].

In the face of such a record it is inconceivable to us how the Government could make such an irresponsible and untrue statement that the landowners’ experts “ignored all of the sales relied upon by the government



witnesses” and that, “*Instead*, they said that Conejo Valley——was an appropriate area to find comparable sales” (Govt. Br. p. 11), with the clear inference that the issue involves merely a choice between two different “groups” of sales.

Again on page 11 of its brief, the Government states: “. . . since the crucial issue in the case is which group of sales are comparable property we will not undertake even to summarize what the testimony was.” The issue is not, and never was between two “groups” of sales—both parties introduced, discussed, analyzed and compared many sales in varying locations and of varying sizes and topography, varying uses, climates, water resources and environmental factors. All these sales were introduced into evidence without objection and by stipulation. The Commission did not accept one “group” and reject another “group.” Instead, after carefully examining all of the sales called to their attention by the parties, and hearing the witnesses for both sides describe, discuss, analyze and compare these sales with the subject properties, or portions thereof, the commission did not “adopt” any particular group of sales. They did make a finding as follows:

“21. The Commissioners find that, in consideration of *all* of the evidence, the burden of proof of the defendant has been sustained, and that compensation in the amounts hereinafter set forth is sustained by a fair preponderance of all of the evidence, including evidence obtained by the Commission on its view of the premises, the surrounding area, and *the alleged comparable properties to which the attention of the Commissioners was directed by the parties.*” [R. 48-49—italics added].



The Government on pages 11 to 15 of their brief purports to set forth “highlights of evidence” in the *Battin* transcript. We shall not respond in detail because we do not have the *Battin* transcript, but we would like to point out that such “highlights of evidence” can have no importance or relevance to the *V-R Ranch* case. The *Battin* case was a taking of only 3.28 undeveloped acres out of a larger parcel of 68.51 acres, compared with the *V-R Ranch* taking of 826.06 acres out of 1594 acre larger parcel, and included on the part taken in the *V-R Ranch* case was an existing lake or reservoir with a surface elevation of 491 feet, an area of 17.27 acres, and capable of storing as of the date of the take approximately 338 acre feet of water [R. 25].

Furthermore unlike the *Battin* case, the *V-R Ranch* property was extensively developed as found by the Commission as follows:

“(g) Classification No. 7. An area of 12.06 acres referred to in some of the testimony herein as either “Headquarters Area” [395] or “Dude Ranch Area,” comprised of level, highly developed lands upon which are located the following-described ranch improvements: Main ranch house, domestic water lines supplied from nearby springs and other improvements, a duplex, foreman’s house and office, guest house, bunk house, ranch kitchen, dining room and apartment, horse barn and corrals, dairy units and milker’s house, work shop, butcher house, hay barn, hay shed, sale house and cattle pens, tool shed, filling station and other minor improvements, including roads, fences, underground piping, cattle guards, and so forth. That

said improvements at the date of said take constitute a unit for agricultural products, and a dairy, cattle and dude ranch. That in addition to the foregoing improvements, the said parcel CR 17—826.06 acres—included an irrigation system—permanent and mobile—water distribution system, concrete pipe basins and concrete watering troughs, fire hydrants, sprinkler outlets, etc.” [R. 28-29].

For the foregoing reasons, and by reason of the entirely different type, size and improvements of *V-R Ranch* property and the *Battin* property, we do not believe that the alleged “highlights of evidence” from the *Battin* transcript have the slightest relevancy to the *V-R Ranch* case.

### **Comment on Government’s “Specifications of Error.”**

The so-called Specifications of Error, set forth on pages 15 and 16 of the Government’s brief, require a brief comment before answering Government’s Arguments I, II, III and IV.

Appellee seriously doubts the sufficiency of the Government’s Specifications of Error to properly present to this Court the question of whether the District Judge properly performed his function in resolving the issues presented by the objections heretofore filed. The Specifications of Error purport to be 15 in number but upon analysis, it is clear that there are many duplications. Specifications 1, 2, 4, 9, 10, 11, 13, 14 and 15 do *not* comply with Rule 18(2)(d) of Rules of this Court that each specification shall set out “separately and particularly” each error intended to be urged, and

where the error alleged is to a ruling upon the report of a master the specification shall state the “exception to the report and the action of the court upon such exception.” These Specifications are so general and vague as not to apprise this Court or Appellee what the errors complained of are (See *Lee v. United States* (CA 9) 238 F. 2d 341).

*Specifications 3, 5 and 6*, though stated in different words are the same objection and seek to raise again the issue of the adequacy of the commissions’ report already decided by this Court on the previous appeal. We will hereafter answer this issue under our Argument I. We believe the reasoning of this Court in *United States v. Lewis (supra)* is unanswerable. We can but repeat what we said in the prior appeal on this issue in response to the same contentions. For the convenience of the Court, rather than repeating such matters in the body of this brief, we attach hereto as Appendix “C”, our “Answer to Appellants Argument “C”—from Appellees Answering Brief in *United States v. V-R Ranch*, No. 17501, being pages 31 through 34 of that brief”.

*Specification 7* states that the Commissioners reports are clearly erroneous for five stated reasons, which we will answer under our Arguments II and III in answer to Government’s Arguments III and IV.

*Specification 8* (Govt. Br. p. 16) has no bearing on *V-R Ranch* case, but only to *Battin* case.

*Specification 9*, that “The awards are not supported by substantial admissible evidence”, is so vague as to be completely meaningless. We can but repeat what we said in our brief on the previous appeal where we stated:

“Referring to the third objection the Government made to the report [R. 62], Appellee faces the same dilemma that it faced before the District Court. The Government was unable or refused to specify the nature of the so-called “irrelevant and immaterial matter and speculative and incompetent testimony” to which it refers. It did not before the District Court and still does not before this court specify the nature of this matter. It would not state whether it was referring to any of the exhibits in evidence, which were before the District Court, or whether it was referring to oral testimony, or whether the testimony referred to valuation matters or water resources, or what the general nature of the matter was. It was pointed out that Appellee was ready to discuss and analyze any specific bit of evidence or testimony, but could not do so in response to a general shot-gun objection, which, in the absence of specification, is meaningless. It was pointed out that since the Government’s attorney had been in charge of the case throughout, was present at all sessions, and had taken voluminous notes of the testimony, that he was in a position to point out the objectionable matters to the court. Upon his refusal to do so, the objection was untenable. . . . But surely the Government’s attorney must have known, at least in general terms, the items of testimony to which it objects, if the objection was presented in good faith; but Appellee still does not know what the Government is talking about.”

The Government still has not specified what evidence (it was all admitted without objection and by stipulation) it considers inadmissible.



*Specification 11* that “The district court erred in submitting these cases to commissions under Rule 71A(h)”, is not a proper issue on this appeal. It has already been decided adversely to the Government’s contentions in *United States v. Hall* (1960—9 Cir.), 274 F. 2d 856 (certiorari denied by Supreme Court May 23, 1960 *re United States v. Hall*, No. 850 O. T. 1959).

*Specification 12* that “The commissions’ findings that there were very few sales of comparable properties in the immediate area are clearly erroneous and contrary to the records”, is the only one of 34 objections of plaintiff to the commissioners’ report [R. 62-76] which the Government has seen fit to discuss on this appeal. This is objection No. 10 [R. 64-65] which reads as follows:

“10. Contrary to the allegation in Finding No. 5 of said report at page 9, lines 4-5, that “there were very few sales of real property of sizeable acreage within the area” there were numerous such sales consisting of the following:

Plaintiff's Comparable Sale No.	Acres	Distance by Highway from subject parcel
2	62.15	7.0 miles
5	183	2.4 miles
16	68	5.5 miles
17	824.90	7.6 miles
27	188	8.2 miles
35	78.69	14.5 miles
36	131	14.2 miles
45A	230.4	17.9 miles
46	128.12	17.2 miles”



The foregoing is the list of nine sales which the Government called to the district court's attention as contradicting the finding objected to. The finding to which this objection was made (designated as "Finding No. 5 of said report at page 9, lines 4-5", which refers to the mimeographed report) consists of the phrase in the last paragraph on page 19 of the record. The entire paragraph is as follows:

"There were very few sales of real property of sizeable acreage within the area and there were very few sales of real property within the area which this Commission found to be comparable or similar to CR 17, as a whole, and that for all of the reasons hereinabove set forth it was necessary for the undersigned Commissioners, in arriving at the fair market value of said parcels, to consider sales of comparable or similar properties outside of the immediate area of said parcels." [R. 19—last paragraph].

It can be seen that the entire paragraph when read in its entirety and in context is actually twofold:

(1) "That there were very few sales of real property of sizeable acreage within the area." This is the phrase to which objection 10 [R. 64-65] was directed and which is included in the specification in the objection of "Finding No. 5 of said report at page 9, lines 4-5". This is the substance of Specification 12 (Govt. Br. p. 16), although the Government, with characteristic lack of precision, changes from "within the area" [R. 19] to "in the immediate area" (Govt. Br. p. 16), and from very few sales of "sizeable acreage" [R. 19] to very few sales of "comparable properties" (Govt. Br. p. 16), the question, as we see it

is, did the district judge err in resolving the issues raised by *this objection*. On *this* issue objection 10 [R. 64-65] challenged the finding, “There are very few sales of real property of sizeable acreage within the area,” and listed nine sales [R. 65] relied upon by the Government appraisers as refuting this finding. What is “sizeable”, and what is “within the area?” Bearing in mind that V-R Ranch was approximately 1600 acres and the part taken [CR. 17] was 826 acres, when we examine these sales, as listed in objection 10 [R. 65] as to size, we find that there were only six sales of over 100 acres—these are Plaintiff’s Comparable Sales No. 5 [Deft. No. 23-2]; No. 17; No. 27; No. 36; No. 45A and No. 46 [Deft. No. 22.1]. If we consider these six sales as “sizeable”, how many of the six are “within the area”? If we say within 10 miles of CR 17 is “within the area”, then it appears (from the Government’s own list [R. 65]) that there are only three sales of sizeable acreage (100 acres or more) within 10 miles of CR 17—these are Sale No. 5—183 acres, 2.4 miles distant [this is also Defts. Sale No. 23-2]; No. 17—824.9 acres, 7.6 miles distant and No. 27—188 acres, 8.2 miles distant. Certainly three sales out of 34 sales [See Pltf. Ex. 3—Tr. 2128] used by the Government are “very few sales,” and based on the Government’s own objection, the finding to which the objection was directed that, “There were very few sales of real property of sizeable acreage within the area” [R. 19] is not clearly erroneous, but well supported.

(2) The second aspect of the finding to which the Government objected below was the next phrase of the paragraph [last paragraph R. 19] reading:

“and there were very few sales within the area which this commission found to be comparable or similar to CR 17, as a whole . . .”

This part of the finding was the target of objection No. 11 [R. 65] which objection amounts to no more than a word quibble, that the finding was “misleading” and does not provide a basis for the commissions’ use of sales outside the area in that there was no evidence in the proceedings as to any sales outside “the area”, which were comparable or similar to CR 17 as a whole [R. 65]. All the witnesses used sales outside “the area”, all the sales were introduced without objection, the commission saw them all. The answer to objection 11 was simple. None of the witnesses contended there were *any* sales inside the area or out that were comparable *as a whole* to CR 17. Furthermore the report says, “and for all the reasons hereinabove set forth” [R. 19—in last paragraph] it was necessary to “consider” sales of “comparable or similar properties outside the *immediate area* of said parcel.” [R. 19—last paragraph]. (*italics added*). These reasons, among others, are the tight ownership in which properties in the immediate area were held [R. 19]; that property in the immediate area were in transition stage [R. 19]; also Finding 7 [R. 20-21] which is unchallenged. Since this limited issue raised by objection No. 11 [R. 65] is now apparently abandoned by the Government on this appeal, it is not within the ambit of Specification 12, we will not *further* argue this point.

*Specification of Error No. 13* states that the district judge erred in that:

“13. The landowners’ valuation evidence was inadmissible for lack of proof of foundation facts.” (Govt. Br. p. 16).

While the issue attempted to be raised by this specification will be answered more fully hereafter in our answer to the Government’s Argument III, we cannot refrain from pointing out that as a Specification of Error, it is frivolous, and raises no proper issue before this Court. No objection to the introduction of any evidence was made either to the commission or to the district judge. We do not know what “valuation evidence” the Government is talking about and we respectfully submit the Government does not either. Do they mean the valuation opinions expressed by the witnesses?—and if so which witnesses and why?—the witnesses’ opinions of highest and best use?—the physical facts concerning the property?—the condition of the market?—the climate?—the water resources available to CR 17?—the reconstruction study?—the sales?—and if so, what sales?—and what foundation is lacking? We can only assume the Government means the comparable sales (if it means anything by this, “how long is a piece of string?” objection). But which ones? The sales data of all of the sales for both parties was admitted *by stipulation* and without objection [See list of Government sales, Pltf. Ex. 3—Tr. 2128; see also list of landowners’ sales in evidence *by stipulation*—Deft. Ex. “V”—Tr. 66.] Each of the landowners’ experts discussed, analyzed and compared each sale in great detail [see testimony George S. Mann—Tr. 1273-1341; Jerry B. Carll, Sr., Tr. 1781-1840]. Every conceivable *fact* regarding each sale was brought out on both direct and cross-examination.



*Specification of Error 14* states:

“14. The landowners’ opinion evidence was contradicted by all the facts in the record.”

This specification is so general and sweeping as to verge on the ridiculous. Certainly the Government cannot mean that *all* of the facts contradicted these opinions but that is what the specification states. No such issue was ever presented to the district judge whose function, now being tested on this appeal, is to resolve the issues raised by the objections. Certainly the facts set forth in Finding 5 [R. 13-20] relating to the economy, history and growth of the area, including the immediate environs of the subject parcel do not contradict these opinions—nor do the facts set forth in Finding 6 [R. 20] or Finding 7 [R. 21] contradict these opinions—nor the physical characteristics and highway and transportation facilities set forth in Finding 8 [R. 21-23]—nor the facts relating to the climate in the area [R. 23-24]. Can it be said that the facts set forth in Finding 10 [R. 24-30] relating to the area, topography, terrain, vegetation and improvements on the larger parcel of which CR 17 was a part only, contradict “the landowners opinion evidence.” And what about the water resources available to the property set forth in Finding 11 [R. 30-32] and Finding 12 [R. 32-34] and Finding 13 [R. 34-35] and the highway access and freeway development in relation to CR 17 set forth in Finding 15 [R. 35-36]? Yet the Government says *all* the facts contradict our opinions evidence and the specification is patently ridiculous. If by “landowners’ opinion evidence” the Government means the opinions of value expressed, the Government loses sight of the fact that the commission did *not*



adopt these opinions of value. As we stated in our brief on the previous appeal, the opinions of *just compensation* of the defendant's witnesses were as follows:

Ralph B. Nunnolley	\$2,322,000.00	[Deft. Ex. "2W," Tr. 765]
George S. Mann	\$2,023,500.00	[Deft. Ex. "3D," Tr. 1263-1265]
Jerry B. Carll, Sr.	\$2,016,475.00	[Deft. Ex. "3F" (Appx. "B"), Tr. 1681-1684]

The award of \$1,163,400.00 [R. 51] is thus *over* \$850,000.00 *less* than the *lowest* opinion of the landowners' experts.

As stated in *United States v. Waymire* (10th Cir. 1953), 202 F. 2d 550, 554:

"No good purpose would be served in reviewing in detail the testimony of the several witnesses. It is enough to say that the several awards as finally approved by the court and merged into the judgment are adequately sustained by evidence in respect to amount and therefore are not subject to attack for excessiveness."

*Specification of Error 15* stating that:

"15. The judgments include duplicated or contradictory awards."

Will be answered hereafter in our response to Appellants Argument IVB. However, we wish to point out at this time that this specification does not set forth any issue whereby the District Judge erred in resolving the issues raised by the objections since the objections did not present any such issue to the district judge for resolution [See Objections R. 62-77].

## ARGUMENT I.

### Contrary to What the Government Argues in Its Arguments 1 and 2, the Adequacy of the Commission's Report Is Not Now Open to Appellate Review.

In its questions 1 and 2, the Government seeks to again raise the question of the adequacy of the commission's report under Rule 71A(h), Federal Rules of Civil Procedure, and to raise the question of whether the "conclusory findings" are supported by adequate subsidiary findings. We do not know which of the twenty-two findings made by the commission [R. 9-53] the Government means to characterize by the adjective "conclusory" (the dictionary definition of which is "conclusive [rare]"), but we do not believe that the adequacy of the findings is again properly before this Court. It is beyond question that the findings in question have clearly been held to be adequate by this Court on the prior appeal, and it seems likewise clear that the ruling is controlling as the "law of the case", not only upon the court below, but upon this Court.

In *United States v. Lewis* (1962), 308 F. 2d 453, 459, this Court said on page 460:

*"Benning and Morrison Cases.*

"Here, as in the Lewis and Gill cases, the United States objected to the commission's report and findings before the district court as inadequate and makes the same contentions here on appeal. In these cases, unlike the two already discussed, the contentions are without merit.

"Here the report and findings meticulously deal with the question of highest and best use. A substantial portion of the property was found to

be residential in character; for subdivision or rural estates. A lesser portion was found to be most useful as watershed protection or for cattle grazing. Subsidiary findings dealt with various aspects of residential land values; the locational potentialities of the area with respect to the population centers of Southern California; climate and cultural advantages of the Ojai Valley; topography; water supply and potential development of water resources; highway access; the existence of willing buyers.

“[7] The objections of the United States in those cases seem to be directed to the fact that the findings and report do not disclose what proof the commission relied on and why the commissioners chose to believe certain witnesses and accept certain evidence as more credible than other witnesses and other evidence. Findings need not be so comprehensive. They should, as the United States asserts, show “how” material factual disputes relating to value have been resolved. But this requirement relates to a showing of the result—the fact as found—and not to a detailed itemization of the proof relied upon in order to reach that result. We conclude that the finding and report in each case are sufficient.”

In regard to the *V-R Ranch* case report [R. 9-53], the adequacy of which the Government again seeks to review, this Court said on page 460 (308 F. 2d):

“The issues are the same as those in *Benning* and *Morrison* and require the same disposition. Here, as in those cases and for the same reasons, the attack of the United States upon the adequacy of the commissions’ report is without merit.”

Thus, it is clear that the finding that the commission's report is adequate is the "law of the case" and equally binding on the court below as on this Court.

In *City of Seattle v. Puget Sound Power & Light Co.* (1926—9 Cir.), 15 F. 2d 794, the Court said at page 795:

"[1] The rule is firmly established that the decision of the appellate court on appeal or writ of error is controlling upon the *court below* after the case has been remanded, and it is equally controlling upon the appellate court on a second appeal or writ of error in the same case. No doubt isolated cases may be found where appellate courts have disregarded the rule, and their power to do so is not questioned; but the overwhelming weight of authority is in its favor, unless between the two decisions there has been some change in the law, by legislative enactment or *judicial decision which the appellate court is bound to follow*. The rule itself has been iterated and reiterated by the Supreme Court and by this court. \* \* \*"  
(italics added).

In *General American Life Ins. Co. v. Anderson* (1946—9 Cir.), 156 F. 2d 615, at 618, the court said:

"This rule of 'the law of the case', is a salutary rule, necessary as a matter of policy in order to end litigation. It is based upon the ground that there would be no end to a suit if every obstinant litigant could by repeated appeals compel a court to listen to criticisms on their opinions, or speculate on changes of its members. *Roberts v. Cooper*, 20 How. 467, 481, 15 L. Ed. 969; and it would be impossible for an appellate court to perform



its duties satisfactorily and efficiently if a question once considered and decided by it were to be litigated anew in the same case upon any and every subsequent appeal. \* \* \*

After admitting that the appellate court had the abstract power upon a second review to reach a result inconsistent with its decision on the first review of the same case the court in *Anderson* stated, quoting from *Chesapeake & Ohio Ry. Co. v. McKell* (6 Cir.), 204 Fed. 514, 516 (page 619, first column):

“\* \* \* but this is a power to be exercised very sparingly, and only under extraordinary conditions. The practice that such a decision be treated as law of the case, to be followed by the appellate court itself as well as by the trial court, is most salutary and its violation (save in rare exceptions) would intolerably unsettle all litigation. The power of an appellate court to review questions involved in a former decision and reach a different result may not be exercised except in a very clear case.”

In *Wyant v. U. S. Fidelity & Guaranty Co.* (1940—4 Cir.), 116 F. 2d 83, the court said on page 85:

“Of course the matters settled on the second appeal in this case cannot be reopened on this appeal.”

See also *Hildreth v. Union News Co.* (1963—6 Cir.), 315 F. 2d 548.

The Government seeks to justify the re-examination of the issue of the adequacy of the report herein on two grounds: first, that the Supreme Court has granted certiorari in two cases “relating to this situa-



tion", and, second, that "evidence is now available for this Court so that the inadequacies of the reports now become clear" (Govt. Br. p. 23). We will answer these contentions separately.

On the first contention, it seems clear that there has been no "change in the law, by legislative enactment or *judicial decision which the appellate court is bound to follow*" (italics added), which the *City of Seattle* case, *supra*, stated was the only justification for disregarding the rule of the law of the case, nor does the reason advanced by the Government amount to the "extraordinary conditions" referred to in the *General American Life Ins. Co.* case, *supra*.

The granting of certiorari by the Supreme Court in the two cases, which the Government describes as "relating to this situation" does not justify a re-examination of the adequacy of the report.

Concerning the cases "relating to this situation" upon which the Supreme Court has granted certiorari, the case of *United States v. Mers* (1962—10 Cir.), 306 F. 2d 39, involved condemnation of clearance easements for airplane approaches. The parties stipulated to the highest and best use. The commission report cited the order of reference and contained ultimate findings only as to amount. The United States objected to the adequacy of the report *but made no request for specific findings*. A supplementary report which included findings of fact was filed, and this subsequent report made findings as to the height of the clearance easements over each tract together with findings of highest and best use for agricultural purposes, and concluded with findings on just compensation. The 10th Circuit Court of Appeals held the subsequent report was adequate

and that more specific findings would be of no help and that the supplemental report was entirely adequate to permit the court to review the uncomplicated issues and that the report was not clearly erroneous. The Supreme Court granted certiorari.

It can be seen that the report in the *Merz* case differs entirely from the report herein, and the fact that the Supreme Court has granted certiorari therein has no application to the instant situation, and the granting of certiorari therein creates no "change in law".

In the second case referred to by the Government (Govt. Br. p. 16) *United States v. 2872.88 Acres* (1962—5 Cir.), 310 F. 2d 775, all the report there did was to *recite* the substance of the valuation testimony given by the witnesses, and make ultimate findings of market value and severance damages, and the only specific findings were as to value of easements and fences taken, or the costs of fencing the remaining tracts (310 F. 2d 777). Thus it is clear that what the court stated, as cited on pages 22 to 23 of the Government's Brief, was directed toward *that* report and cannot apply to the detailed specific findings in the report in the instant case. The *2872.88 Acres* case cited *United States v. Lewis* (1960—9 Cir.), 308 F. 2d 453, with approval and stated at page 779 (310 F. 2d):

"We do not say that every contested issue raised in the record before the commission must be resolved by separate findings of fact. We do say, however, that there must be sufficient findings of subsidiary facts so as it will appear to the reviewing court that the ultimate finding of value was soundly and legally based."

This Court in *Lewis* has already held that the subsidiary findings are sufficient, and we do not believe this matter is properly open to re-examination.

So far as the second alleged reason for a re-examination of this Court's decision on the adequacy of the report, *i.e.*, that the evidence is now available for this Court so that the inadequacies of the reports "are now clear", we will discuss the contentions of the Government hereafter in answer to the Government's Arguments III and IV. This second alleged reason is clearly directed at the question of the sufficiency of the *evidence* to support the subsidiary findings, and not at the sufficiency of the subsidiary findings to support the award. The two questions are quite separate. This Court has already held that the reports are adequate as clearly and unequivocally as it is possible to do so. The Government by declining to file the transcript on the first appeal represented to this Court that examination of the evidence was unnecessary for this purpose. It is illogical for the Government to say, as they did on the first appeal, that this Court must determine the adequacy of these reports from the reports themselves, but having determined that they are adequate, this Court must now review the evidence to see if they are inadequate.

But again we wish to state that we feel strongly that it is the action of the District Court in resolving the issues presented by the *objections* to the report that this Court should review, and not the report in light of the entire evidence as the government contends. This Court stated in *Lewis* on the previous appeal when the Government appeared to urge upon this Court a sort of supervisory function in the abstract:

“This course we reject. If there be inadequacies in a particular report, they must be *specified* by objection to the report. If any case is to be remanded for correction of error in this area, it must be with instructions that by report or finding resolution of some *specific dispute* be made on some *specific inadequacy* be remedied. Otherwise, as we view the matter, there could be no end to these litigations.” (308 F. 2d 456; italics added).

The issues raised by the objections heretofore filed [R. 62-76] were resolved by the District Judge, on review of the transcript, after oral and written argument, and the Government on this appeal, improperly we believe, has not seen fit to bring up for the examination of this Court the transcript of this hearing, nor to discuss in their brief the objections heretofore filed and argued with the transcript of testimony taken before the Commission. In addition to *extensive* oral argument on the objections, the Government filed a partial memorandum in support of objections 6 [R. 63], 7 [R. 63-67], 8 [R. 64] and 12 [R. 65-66], to which we responded in writing, and we attach as Appendix “D” to this brief appellees’ written response thereto.

In its brief (page 5), the Government states, regarding these hearings before the District Judge, “There was no discussion by the court of the issues raised in any of these cases.” It is true that the District Judge did not issue a written opinion, but there was a great deal of discussion of the objections raised, the exhibits introduced before the commission at both hear-



ings, the first without and the second with the transcript, which indicate a very careful consideration of each objection, and yet the Government is expecting this Court to “review the District Judge not the commission” without bringing the transcripts of these hearings to this Court for review. The Government has utterly failed in showing that the District Judge erred in carrying out his function “to review the commissions’ report and findings *in light of the objections made to it* and to resolve the issues presented by *such* objections.” As we will develop later in this brief, the issues raised on this appeal were not even presented to the District Court. How can the District Court be said to have erred in the resolution of issues not even presented to it for resolution?



## ARGUMENT II.

### Answer to Government's Argument III That Resort to the Record Shows That the Findings Are Clearly Erroneous.

Before discussing the Government's arguments in detail we would like to set forth our understanding of the issues properly before this court on this appeal. We repeat that this Court reviews the *district judge* and not the commission. Therefore, as we see it, issues *not* presented to the district judge for resolution and not passed upon by him are not properly before this court for review. The Government asks this Court to review the entire transcript to determine whether the report is "clearly erroneous". We believe that clearly, under the rules, the Appellant has the burden to show the *district court* that the commissions' report was "clearly erroneous", and to specify to this Court wherein the district court erred in carrying out its function to review the commissions' report and findings *in light of the objections made to it*, and to resolve *the issues* presented by *such objections*.

In its Argument III the Government relies on three contentions: (A) The findings of a highest and best use at the date of taking for residential subdivision use are clearly erroneous (Govt. Br. pp. 31-40); (B) That the commission "rejected" the sales relied on by the Government and that such rejection was unjustified (Govt. Br. pp. 40-43); and (C) The sales relied on by the commission were not of comparable properties (Govt. Br. pp. 43-46).

With the possible exception of contention IIIA, these contentions were *not* within the issues presented to the district judge by the objections to the report. Clearly

contention IIIB, regarding the commissions' alleged rejection of the Government sales, and contention IIIC, that the sales relied on by the commission were not of comparable properties are not by any stretch of the imagination within the objections presented to the district court. Examination of the objections [R. 62-77] shows this to be true, and we request that the Government point to the objection or objections which raised the issues set forth in contentions IIIB and IIIC before the district judge. It cannot be done.

**A. Answer to Government's Argument IIIA That Findings of Highest and Best Use for Residential Subdivision Are Clearly Erroneous.**

With regard to the Argument IIIA (Govt. Br. pp. 30-40), that the findings of highest and best use for residential subdivision are "clearly erroneous", the only objection that even remotely raised such issue to the district judge is the objection 22 [R. 71] to the effect:

"22. There is no evidence in the proceedings, other than the *bare opinion* of the defendant's witnesses to support the finding set forth in Finding No. 18 of said report on page 27, lines 22-24, that "321.03 acres, referred to hereinabove as Classification No. 1 of the larger parcel, had a highest and best use for the development and for use as a residential subdivision." (italics added).

This objection 22 was fully argued before the district judge. The objection was, as can be seen, not that such finding was "clearly erroneous" for the reasons now advanced on this appeal, but that there was "no evidence in the proceedings, other than the *bare opinion* of defendants' witnesses" to support Finding 18(a) R. 43 [See Objection 22—R. 71].

It was pointed out that highest and best use is of necessity an opinion of well qualified persons. That it was not a “bare” opinion (by which we must assume an opinion without any reasons to support it) is shown by the detailed reasons and facts given in support thereof. For example see testimony of Jerry Carll, Sr. [Deft. Ex. “3F”—Appendix “B” to this Brief—Tr. 1684] and his detailed testimony [Tr. 1687-1689]. Furthermore the 321.03 acres in question is fully described under classification 1 as follows:

“(a) Classification No. 1. That an area comprising approximately 321.03 acres consists mostly of gentle sloping, rolling land, including 214.82 acres lying to the east of Coyote Creek and 106.21 acres of land lying to the west of said Coyote Creek, a natural water course, and that this area contained a scattering of large live oak trees; that most of the area had been cleared of native vegetation prior to the take, and much of this area had been used for permanent pasture when the property was operated as a balanced unit for agricultural products and a dairy, cattle and dude ranch prior to the take. The portion east of Coyote Creek had elevations of approximately 475 feet at the lowest point to approximately 725 feet at the highest point. [393]

That lying between the two areas heretofore discussed was an existing lake or reservoir referred to as “Deep Cat Lake” with a surface elevation of approximately 491 feet, an area of 17.27 acres, and capable of storing as of the date of take approximately 338 acre feet of water. That said lake or reservoir is formed by a dam built in 1951.

That as of the date of take herein, the owner of the subject property had a valid and existing permit from the State of California Department of Public Works, Division of Water Resources, for the appropriation of 418 acre feet per annum from Coyote Creek to be collected between November 1 and June 30, the storage to be effected by means of said earth filled dam 555.5 feet high by 366 feet long. That said dam and reservoir included the necessary appurtenances, such as tower pump, house, equipment, and so forth, for the distribution and utilization of water stored for us upon the property.

Appurtenant to said Deep Cat Lake is an easement to impound waters upon the "Fowler" property. That said easement has no value in and of itself, separate and apart from the value of said Deep Cat Lake."

It was likewise pointed out to the district judge that the commissioners had fully viewed the property, seen detailed photographs and maps, and had made findings regarding the economic background, history, population growth, environmental factors [Finding 5—R. 13-20], the climate [Finding 9—R. 23-24], the water resources available [R. 30-32], etc. etc. All the foregoing findings contain facts (undisputed on this appeal) which indicated that the property was ideally suited for residential subdivision uses.

Furthermore the Government's own witnesses recognized the residential subdivision potentialities of the *V-R Ranch* properties. Mr. Evans, whose opinion of highest and best use was a stock ranch, a dude ranch



or to divide the property into smaller ranches [Tr. 2159-2160] or use part as a golf course [Tr. 2162, line 10] or could physically cut into 1 to 1½ acre lots and sell quite a few [Tr. 2162] or to subdivide into smaller estates, with dairy ranch “or what have you.” [Tr. 2407, line 20, to 2408, line 7].

Mr. Sando had a highest and best use opinion of V-R Ranch as a cattle ranch in the main sense with the potential subdivision of a small part of it [Tr. 3545, lines 7-22], 20 acres at a time [See also Tr. 3778, line 3 *et seq.*]

In addition to the opinions and reasons therefor stated by well qualified appraisers [their qualifications are in evidence by stipulation in defendant’s Ex. “U”, Tr. 61], 250 of the 321 acres in question had already, prior to the taking been approved for subdivision [see Deft. Ex. “L”, Approved Tentative Subdivision Map dated April 1, 1956—in evidence by stipulation Tr. 41]. So it is clear that on the limited issue raised below that there was no evidence other than the “bare” opinions of defendants’ witnesses the district judge did not err in refusing to find that this finding was “clearly erroneous”. Indeed, had the district judge so found he would have abused his discretion. See for example the testimony of Jerry B. Carll, Sr., Tr. 1687 to 1689.

We now turn to answering Appellant’s Argument III on the merits, without prejudice to our position that these issues are *not* properly before within the scope of this Court’s review. On page 30 of its brief the Government states, “The comparable sales are given by the reports as the only basis for the commissions’



conclusions.” This just is not so. In addition to detailed and meticulous findings which this Court held adequate on the previous appeal, the commission found:

“The undersigned Commissioners having heard the testimony, both oral and documentary, presented by plaintiff and defendant, and being fully advised in the premises and having duly considered all of the evidence and testimony presented herein for and on behalf of plaintiff and defendant, *and having viewed the property*, and property alleged by the parties to be comparable to the subject property, and having examined and studied in detail all exhibits introduced in evidence by plaintiff and defendant, and having considered in [382] detail legal authorities and arguments of counsel, the undersigned Commissioners hereby make their report and findings as hereinafter set forth.” (italics added).

On page 32 of its brief, the Government says: “The error was in the area they believed to be comparable”, and on page 33 that they are not objecting to the exercise of the trier’s discretion as to consideration of particular sales deemed to be dissimilar, but “It is rejection of all of the 28 sales relied upon by the Government”.

The commission did *not* reject all 28 sales relied upon by the Government. We will answer this unwarranted assumption made by the Government hereafter under our answer to the Government’s Argument IIIB.

In its Argument IIIA (2), pages 33-36 of its brief, the Government *assumes* directly contrary to the report

that the commission valued the property as if the property were not being used for its highest and best uses found, and not to the extent that the potentiality for such use affects the present market value. But this assumption has no support in the record and is completely unjustified.

It is perfectly clear from the record that the commission did not value the V-R Ranch Company property as if the property were *now* being used for the highest and best uses found. Since the Government took possession of V-R Ranch in August, 1957, and since the matter was not tried until 1960, the ranch was not in operation, as such, at the trial. With regard to its *Classification No. 1*—321.03 acres, the commission found, among other things:

“\* \* \* that most of the area had been cleared of native vegetation prior to the take, and much of this area had been used for permanent pasture when *the property was operated as a balanced unit for agricultural products and a dairy, cattle and dude ranch prior to the take.* \* \* \*” [R. 25; italics added].

This court stated on the previous appeal:

“The highest and best use is not found from the past history or present use of these lands but *from reasonable future probability* in light of the history of the region in general in its transition from agricultural to residential character.” (*United States v. Lewis*, 308 F. 2d 461; italics added).

That the commission, in finding highest and best use for various portions of V-R Ranch, was concerned likewise with reasonable future *probability* is clear from

the detailed and meticulous findings regarding the economy, history and growth in the area [Finding 5—R. 13-20].

Furthermore, in its finding of highest and best use of the area described as Classification No. 1 [321.03 acres, described—R. 25], the commission found this 321.03 acres “had a highest and best use *for the development* and for use as a residential subdivision” [R. 43; italics added]. On highest and best use for its Classification No. 2 [154.26 acres described in Finding 10(b)—R. 26], it was found to be “for *development* as rural homesites” [R. 43; italics added]. The same is true of its Classification No. 3 [38.52 acres described in (c) R. 26] where the highest and best use was found to be “for *development* for view type country estate or estates” [R. 43; italics added]. Also its Classification No. 5 [67.60 acres described in (e) R. 27], the 16.50 acres referred to as “Proposed Lake No. 2” was found to have a highest and best use “for *development* of a storage reservoir, and the balance for *use* as cabin *sites* and the 9.70 acres of creek bottom lands “for *developing* a water supply by building of a dam at the Dunshee Narrows or for cabin sites” [R. 44; italics added].

Thus it is clear by the use of the words “for *development*”, implying probability of future use, that the commission did *not*, as the Government unsupportedly *assumes* it did, value the property as if it were now used for such purposes. On the contrary, this is what the commission did *not* do, but it found that the property was reasonably adaptable for development to such uses, and specifically found:

“20 The Commissioners find that as of August 12, 1957, there were willing buyers in the open market for lands which were reasonably adaptable to all the uses which the evidence of both plaintiff and defendant showed that the lands in the subject property were reasonably adaptable and capable of being used as of said date.” [R. 48].

The commission also found in Finding 6 [R. 20] that there were buyers in the open market seeking to acquire lands of the character of said parcel “for development and use” and that:

“\* \* \* said buyers were acquiring similar or comparable properties for both immediate development and use and also for future development and use.”

Furthermore, after finding in detail the water resources available to the *V-R Ranch* property in its Finding No. 11 [R. 30-32], the commission specifically found that:

“\* \* \* the aforesaid water resources, assuming maximum development as afore said, provides for the *development* of said property to the uses and purposes hereinafter in these findings set forth.” [R. 32; italics added].

These few references to *development*—there are many more—make it abundantly clear that the commission did not value the property “as if it were *now* used for such purposes” (Govt. Br. p. 33).

The Government, in its brief (p. 36), states that:

“The reports are, thus, explicit that the commissions have used the forbidden process by treating the lands as if they had been subdivided into the various segments described in the findings.”



The Government cites for this proposition the fact that the commission found the highest and best use for certain classifications of land and incorrectly cites V-R Ranch, R. 47-48.—[the correct citation being Finding 18, R. 43-45 and Finding 19 R. 45-46.] Actually the commission, in the *V-R Ranch* case, described 13 classifications of land relating to “the area, topography, terrain, vegetation and improvements \* \* \*” [see Finding 10 — R. 24-30], and since the various types of land had various and different uses, including their highest and best use, the commission found the highest and best use for each of these 13 classifications, both before and after the taking [R. 43-46], and specifically found:

“In arriving at the market value immediately before the taking of the entire parcel of which the portion taken was a part, the Commissioners considered the said larger parcel as a single unit in light of its highest and best use, and also took into consideration all of the uses to which said larger parcel was reasonably adapted at the time of said taking and for which it was reasonably capable of being used as of said date.

“In arriving at the fair market value immediately following the taking of the remainder of the parcel not taken, the Commissioners took into consideration the then highest and best use of the remainder and also took into consideration all of the uses to which said remaining property was reasonably adapted immediately following the taking and for which said remainder was reasonably capable of being used immediately following the taking.” [R. 47-48].



Thus it is clear beyond question that the commission did *not* treat the lands “as if they had been subdivided in the various segments described in the findings” as the Government contends that it did.

All of the witnesses, including the Government witnesses, agreed that the different parts and types of land had different uses and values as part of the whole, and each of the witnesses divided the *V-R Ranch* property into various classifications and uses: [see for example, Deft. Ex. 3F (Appendix “B”) Jerry B. Carll, Sr., Valuation Chart—Tr. 1684, and compare with Pltf. Ex. 8—Bernard G. Evans, Valuation Chart—Tr. 2369].

In its brief (p. 37), the Government, under the heading “4. Facts appearing in the reports controvert the conclusions as to highest and best use”, makes this statement: “But the commissions did not even assert the actual existence of a demand for such properties in the Casitas Valley”. Despite the fact that this statement is in direct conflict with the statement found on page 39 of its brief, “It must be remembered that the commissions found that a demand existed to create this magic city \* \* \*”, we will answer this statement that the commission did not even assert the actual existence of a demand for such properties in the Casitas Valley by referring directly to the report itself. In the first place, the *V-R Ranch* report, finding detailed *facts* relating to the economy, history, and growth of the area, including the *immediate environs* of said property, finds categorically and unequivocally as follows:

“Properties in Ventura County and in the area of CR 17 were at the time of the take *greatly in demand* because, among other things, a large

number of people of retired status were seeking country life on either residential subdivisions, or country estates, or rural ranches, or estates with or without avocado, citrus and deciduous trees either in family orchard size or in [387] small or large commercial developments. \* \* \*.

“That with respect to the lands within the Santa Ana and Coyote Valleys and immediate surrounding areas, many of said properties were in the transition stage from dry farming and more intensive agriculture, to development for small rural estates and residential subdivisions.”

“As of the date of the taking, dry-farmed lands within the area varied widely in price up to a maximum of \$1,000 an acre, with values often having little relationship to agricultural potentialities and prices paid for such lands in the area of said parcels were influenced more by climatic and geographical factors than by soil, topographic and drainage limitations and net farm income.

“The fair market value of lands suitable for the growing of avocados and citrus crops within Ventura County where the land had water immediately available, varied between \$1,600 and \$3,750 per acre.

“There are few areas in as close proximity to the metropolitan areas of Southern California having as desirable a climate, scenic attributes and general cultural environment as the subject parcel had.

“6. *The Commissioners find that as of the date of the take there were buyers in the open market seeking to acquire lands of the character of said parcel for development and use and that these*

buyers were, at the date of the taking, actually acquiring lands similar in type and character to the subject parcel, in other areas such as the Conejo and Thousand Oaks areas for the same or [389] similar uses and purposes and that said buyers were acquiring similar and comparable properties for both immediate development and use and also for future development and use.

“7. The Commissioners find that the buyers in these other areas were acquiring lands for similar and comparable uses in areas having a climate, scenic beauty, water supply and general environment less favorable than that of the subject parcel.” [R. 18-21—italics added.]

In the face of these specific findings, sustained by the overwhelming weight of testimony, it is difficult to conceive how the Government can blandly assert that the reports do not contain subsidiary findings setting forth facts from which a reviewer can weigh the validity of the conclusion as to highest and best use, or that the commission did not even assert the actual existence of a demand for such properties in the Casitas Valley.

Returning to a consideration of the Government's brief, we find that on pages 37-38, the Government quotes (out of context) that portion of finding 5 [R. 13-20] reading:

“That with respect to the lands within said Santa Ana and Coyote Valleys and immediately surrounding areas, many of said properties were in the transition stage from dry farming and more intensive agriculture, to development for small rural estates and residential subdivisions.” (Govt. Br. pp. 37-38).

The Government then states on page 38 of its brief that this “precludes valuation of the lands as hypothetically subdivided at the date of taking, since it recognizes the fact that the alleged transition stage had not been completed.” This is complete nonsense—if the transition stage had been completed, the properties would not be in transition. In the first place, as we stated earlier in this brief, the commission did not value the lands as hypothetically subdivided at the date of taking. In the second place, the Government’s reference to “alleged transition” seems to infer that it questions the validity of this finding that “many of said properties were in a transition stage from dry farming and more intensive agriculture, to development for small rural estates and residential subdivisions” [R. 19].

The finding is taken from page 77 of one of the Government’s own official documents [“Dunshee” Ex. “AA” in evidence by reference on Defts. Ex. “Y”, the list of Exhibits from “Dunshee” cases stipulated in evidence, Tr. 71]. This is referred to as House Document No. 222, being a report of the Regional Director, Bureau of Reclamation, and is in evidence by stipulation. The finding referred to does not say all of the properties within the Santa Ana and Coyote Valleys were in the transition stage, but that “*many* of said properties were \* \* \*”. In addition to Dunshee Exhibit “Y”, above referred to, the map showing “Subdivided Residential Areas” [Dunshee Ex. “V” in evidence by reference on Deft. Ex. “Y”—Tr. 71] shows that the finding is supported fully by the evidence.

In addition to the statement on page 77 of said House Document 222, the commission viewed the entire area and subject parcel on July 26 and 27, 1960 [See



Tr. 75-173] and also viewed the area in connection with CR 19 (Dunshee parcel) for four days, including *all* the sales, under a stipulation that said view would apply also to *V-R Ranch* case [*Benning*, Tr. p. 9, lines 15-24].

The Government quotes, pages 38-39 of its brief, from the *Battin* record, and not having this record or transcript we can only answer by referring to the *V-R Ranch* case. So far as the highest and best use for residential subdivision, we respectfully refer this Court to the finding that the 321.03 acres in Classification No. 1 had a highest and best use for the development and use as a residential subdivision [R. 43—Finding 18a]. This area is described by the commission in its report, which description we have quoted in full on pages 33 and 34 of this brief, and to which we refer this Court without repeating that description.

This finding is unchallenged, and describes land admirably suited for residential subdivision development.

Furthermore, all of the landowners' expert witnesses testified this portion of the property had a highest and best use as for development to residential subdivision and gave detailed reasons for that opinion. See witness Jerry B. Carll, Sr., for example—Tr. 1687 to 1689, and Ex. "3F" [Tr. 1684 — Appendix "B" to this brief]. See also Defendants Exhibit "L", tentative subdivision approval April, 1956—[in evidence by stipulation—Tr. 41] and Defendant's Exhibit "Q" — Estimate of Subdivision Costs [Tr. 54].

In addition to the foregoing, a tentative subdivision map on a portion (250 acres) of Classification No. 1 had already been approved by the Ventura Planning Commission in April, 1956—over a year prior to the



take—[see Deft. Ex. “L”—Tr. 41, consisting of an approved tentative subdivision map of El Rancho Cola—unit No. 1 (133 lots)—scale 1” to 200’—Engineer Ralph B. Nunnelley—R. E. No. 8080 dated April, 1956—approximately 250 acres in Unit No. 1—Also shows projected subdivision Unit No. 2 (147 lots)—club house—chalet development—cabana and swimming pool, etc.—attached thereto is a copy of memo from Secretary of Ventura County Planning Commission to Board of Supervisors (6/12/56); and copy of resolution No. 826 of Planning Commission entitled “Conditional Approval of Tentative Map of El Rancho Cola—Unit No. Subdivision and Stating Conditions of Said Approval in Accordance with Ventura County Ordinance Code”].

Mr. Ralph B. Nunnelley, President of V-R Ranch Company, and a licensed civil engineer, with a vast experience in engineering specializing in subdivision work [see his qualifications set forth in Deft. Ex. “U”—Tr. 61] testified at length regarding the *reasons* why this land had subdivision potentialities [See for example, Tr. 745, line 20, to 746, line 17; see also Tr. 739, line 13, to 745].

The Government witnesses testified that this property was physically capable of development to residential subdivision use but in their opinion had a highest and best use as ranch land because, among other reasons, they *assumed* that it did not have sufficient water resources available to develop it to residential subdivision use [see for example, *Sando* Tr. 3530, lines 21-25].

The commission after extensive water testimony found that this assumption upon which the Government appraisers predicated both highest and best use opinions and values, was not true and found sufficient water for

all the uses and purposes to which they found the property adaptable [see Finding 11, R. 30-33]. The issue regarding the water resources available to *V-R Ranch* property was one of the pivotal points of the entire case and covered 2429 pages of testimony. We attach as Appendix “E” a summary of the transcript dealing with water testimony alone. These exhibits dealing directly with the water resources available to the *V-R Ranch* property are in numbers as follows:

Plaintiff’s water exhibits consisted of 54 out of their total of 61 exhibits.

Defendants’ water exhibits consisted of 45 out of a total of 85 exhibits.

We have listed these exhibits dealing solely with the issue of water resources in Appendix “F” to this brief.

Yet the Government completely ignores this important issue and vast amount of testimony with the single statement, the only reference in its entire brief to the water resources, as follows:

“Also, findings were made at some length concerning the water facilities available.” (Govt. Br. p. 7).

In connection with this point that the commission is supposed to have valued the *V-R Ranch* property as if it were now being used for the highest and best use found the Government states in its Specification of Error No. 7(d):

“the records show that the commissions were valuing on the basis as if the property were now used for the potential highest and best use;” (Govt. Br. p. 15).

Not only is this a completely untrue statement, as we have pointed out above, but it was *not* one of the objections made to the report and hence not an issue resolved by the district judge. We do not know what “records” the Government is talking about—not it is clear, the V-R record—[see Govt. Objections, R. 62-76]—nor the *V-R* case transcript which the Government does not even deign to refer to. The award alone shows this statement to be not true, being as it is more than \$850,000 *below* the low opinion of the landowners’ appraisers.

**B. Answer to Government’s Unwarranted Assumption in Its Argument IIIB That the Commission “Rejected” the Sales Relied Upon by the Government.**

In that portion of its brief under Argument IIIB (pp. 40-43) the Government’s entire argument is premised upon an assumption not borne out by the record, *i.e.*, that the commission “rejected the sales relied upon by the Government.” This assumption is not true. The basis for this alleged error is Government’s Specification of Error 7(a) that among the five reasons why the Government feels the commissions’ reports are erroneous is:

“(a) Adequate reason for rejection of sales in the immediate vicinity was not given.”

This assumption is not a sound one and is not borne out by the record, but before discussing it, we wish to point out that this contention that the commission “rejected” any group of sales and “accepted” another group, is brought into this case *for the first time* on this appeal. It was not a contention raised before the district court on any of the Government’s objections to the *V-R* case report. The *only* one of the 34 objec-

tions raised below, that dealt in any way at all with sales, or commissions' use thereof, was objection No. 10 [R. 64-65] regarding the objection to the commissions' finding that there were very few sales of comparable properties in the immediate area. We have already discussed this objection 10 under our comments regarding Specification of Error No. 12, on pages 19 to 22 of this brief and will not repeat what we said therein. In the first part of its brief the Government asserts that the landowners' witnesses ignored all the sales the government witnesses relied on (Govt. Br. p. 11) and we pointed out that of the 34 sales used by the Government witnesses no less than 15 were the same sales as relied upon by the landowners' witnesses, and now, also without foundation, the Government says the Commission "rejected" the Government sales. On the contrary the report states that the awards are sustained by a fair proportion of *all* the evidence: "including evidence obtained by the Commission on its view of the premises, the surrounding area, and the alleged comparable properties to which the attention of the Commissioners was directed by the parties." [R. 48-49].

What the Government is saying, in effect, is that the report is clearly erroneous because the commission did not accept in its entirety the Government witnesses' opinions and evaluations of these sales and reject in its entirety the reasoning and analysis of the landowners' appraisers—which reasoning and evaluation the Government does not even call to this Court's attention. Obviously whether one property is or is not "comparable" to another depends on many factors—the respective location—size—topography—climate—



water resources, etc. etc., of the two properties, which factors cannot be evaluated without seeing the two properties (as the Commission did), examining all the photographs, topographic maps, reviewing what each witness explained about its similarities and differences—its topography—water resources, etc. etc. Indeed the government appraiser Mr. Sando in discussing his summary—Classifications of Acreage Sales [Pltfs. Ex. 47, Appendix “A” to this brief, Tr. 3572] stated on page 3576, lines 18 to 24 of the transcript:

“In comparing these sales to the subject properties I have considered the various differences that influence the value, such as the size, the availability of water, adaptability of soil, adaptability for rural residential, the topography, location, shape, so forth, plus the important elements of time which I made adjustments for as shown on this tabulation.”

If as the Government *now*, for the first time on this appeal, says the commission “rejected” the sales relied upon by the Government witnesses, the commission must of necessity “rejected” 15 of the landowners’ sales that are duplicates of the Government sales. Such contention is untenable. As stated previously the *V-R Ranch* expert witnesses opinions of just compensation ranged from a high of \$2,322,000.00 to a low of \$2,016,475 and the government witnesses from \$598,000.00 to \$588,250.00. The award of \$1,163,400.00 [R. 51] is thus, taking only the *low* opinions, \$853,075.00 *below* the landowners’ witnesses low opinion and only \$575,150.00 *above* the government witnesses low opinion. Not only is the award, as finally approved by the Court and merged into the judgment, ade-



quately sustained by the evidence in respect to amount and therefore not subject to attack for excessiveness but it (the award) clearly demonstrates that the commission did *not* “reject” one group of sales (the Government’s) and “accept” another group (the landowners’) because had this occurred the award would have been about two million dollars and not over \$850,000.00 below that figure.

**C. Answer to Government’s Contention IIIC That the Sales Relied Upon by the Commissions Were Not of Comparable Properties.**

Like the *assumption* that the commission “rejected” all the Government sales, this is based on the equally unwarranted assumption that the commission relied on one particular group of sales. The Government is again talking about the so-called “Conejo” sales which we have already discussed earlier in this brief. This argument is premised upon Government Specification of Error No. 7(b) that the commissions reports are clearly erroneous because, among other things, “(b) the sales relied upon by the Commissions were plainly irrelevant and noncomparable;” (Govt. Br. p. 15). Aside from the unwarranted assumption that the commission “relied” upon the “Conejo” sales only, this objection comes too late; the time to raise the issue of irrelevance and noncomparability of sales was in the hearing below when the particular sales to which the Government *now* objects were offered in evidence. All of the sales in the *V-R* case were entered in evidence *by stipulation* [see Pltf. Ex. 3—Tr. 2128; and Defts. Ex. “V”—Tr. 66]. Each sale was examined physically by the commission, and each sale offered by both sides were fully described by the witnesses. Photographs and topographic maps

accompanied each sheet covering all the sales data. The Government attorney trying the case before the commission had the right and the duty *at the time the sales were offered in evidence* to object that no foundation showing comparability was laid, and to object to the introduction of any sale offered on the ground that it was “irrelevant and noncomparable.” This was not done. Had the Government attorney made his objection to the introduction of any sale and had the commission overruled such objection, the government trial attorney could have sought and received a ruling on this issue by the district judge. This applies not only to the so-called “Conjeo” sales to which the Government *now* objects, but to all the sales. The objection is too late. It is unconceivable that the Government at this stage only, should contend that any sales, which were introduced into evidence without objection and *by stipulation*, are plainly “irrelevant and noncomparable.” If the Government felt that any sale offered in evidence was “plainly irrelevant and noncomparable”, the Government attorney had the duty to make timely objections *at the time the sales data was offered in evidence*, and secure a ruling thereon. Only then could the relevancy and comparability of such sale, or sales be properly reviewed by this Court.

In *United States v. 18.46 Acres—Vermont* (1963 2 Cir.) 312 F. 2d 287, the Government alleged error in the *exclusion* of testimony as to comparable sales where witnesses were excluded from stating the price of such sales on the ground, of the objection made, that such testimony was *hearsay*. This ruling was held to be error and when the appellee sought to sustain the ruling on the ground that the admission of such testimony is a matter within the judge’s discretion, the

appellate court held that the testimony was excluded on the ground of hearsay and not in the exercise of its discretion stating on page 288 (213 F. 2d):

[4] What has been said also disposes of appellees' second ground of sustaining the ruling, namely, that the government had not laid a foundation for the experts testimony by showing that the sales were comparable. *This was not the objection made at trial, and was not the basis of the judges ruling.* Had an objection been made on that score, the Government might well have cured it, and in any event we think a prima facie showing of comparability was made; *any attack upon it should have developed upon cross-examination . . .*" (Italics added).

In the instant case, not only was no objection made to the introduction of any sale, but a full and complete foundation was laid for each sale, and the Government cannot now object that any sale or sales was or were "irrelevant and noncomparable."

The Government's *present* complaint that the Commissions made no attempt to show that economically the Santa Ana and Coyote Valley were comparable to the Conejo area is likewise untenable. We believe that Finding 5 [R. 13-20] more than covers such objection. Finding 6 [R. 20] also covers such objection fully. Besides the commission specifically found that:

" . . . Conejo Valley is and was a suitable area in which to find sales of property sufficiently alike to give *some reasonable index of value for use in determining the fair market value* of the en-

tire parcel of which the portion taken was a part and also to determine the value of CR 17 as a part of the whole parcel.” [R. 48] (*Italics added*).

This finding was made after, as the commission expressed it:

“ . . . having heard the testimony, both oral and documentary, presented by plaintiff and defendant, and being fully advised in the premises and having duly considered *all* of the evidence and testimony presented herein for and on behalf of plaintiff and defendant, and *having viewed the property, and property alleged by the parties to be comparable to the subject property*, and having examined and studied in detail *all* of the exhibits introduced in evidence by plaintiff and defendant, and having considered in detail legal authorities and arguments of counsel . . .” [R. 11—*Italics added*].

This Court cannot, under the showing made by the Government, find that the report is erroneous on the contention that the “sales relied upon by the Commission were not of comparable properties.” The Government’s burden in showing that the report is “clearly erroneous” is particularly heavy when the commission has viewed and inspected the properties. In *United States v. Twin City Power Co. of Georgia* (1958 5th Cir.), 253 F. 2d 197, 203 the court stated:

“[2] It must be remembered that the ‘clearly erroneous’ burden, both under Rule 53(e) and Rule 52(a), is not a single definite and certain burden, but varies in accordance with the differing opportunities and presumably different of the several tribunals. Among other considerations, for example,



*that burden is especially strong when the commission has viewed and inspected the properties, or when credibility is questioned and the commission has had the opportunity to see and hear the witnesses. \* \* \**” (Italics added.)

In the instant case, as stated previously herein, *all* the appraisers used the *now* objected to Conejo sales. It is true they differed as to their opinions of the degree of comparability from an economic point of view.

But the resolution of these differences of approach and evaluation, *i.e.*, “when credibility is questioned,” is the province of the commission, and the commission having had the opportunity to see and hear the witnesses, the burden of showing that their decision is “clearly erroneous,” is heavy. The Government has not even begun to carry this burden.

The rule is well stated in *Parks v. United States* (1961 5th Cir.), 293 F. 2d 482, 486, as follows:

“Most important for purposes of review, the commissioners themselves went over the extensive ranch and viewed it, thus having the benefit of evidence which cannot be reproduced in the written record. We have carefully read and studied the record, *not for the purpose of usurping the functions of the commission or those of the district court in its primary review of the commissions’ findings and award*, but for the purpose of determining whether the judgment of the district court has been shown to be erroneous and we cannot so find. See *United States v. Twin City Power Co. of Georgia*, *supra*.” (Italics added.)

We believe that the Government in seeking to overthrow the judgment below on the ground that the “Sales



relied upon by the commissions were not comparable properties" (Govt. Br. p. 43 — Argument IIIC) is asking this court to usurp the functions of the commission. Even more clearly, since such issue was *not* raised before the district court [See Govt.'s Objections R. 62-76], this contention asks this Court to usurp the functions of the district court "in its primary function to review the commissions findings and award." What we have said regarding Specification of Error No. 12 (this brief) applies with equal force to this contention and while we refer to what we said there we will not repeat it.

**D. Answer to Government's Argument IIID Regarding Award of Severance Damages in Battin Case.**

The argument set forth in Argument IIID, pages 46-48 of the Government's Brief deals entirely with the alleged error in the award of severance damages in the *Battin* case, and having no connection with the *V-R Ranch* case we will not presume to answer it.

### ARGUMENT III.

#### Answer to Government's Argument IV That Review of Entire Record Shows That the Judgments Are Unsupportable and Unfair to the Public.

In its Argument IV (Govt. Br. pp. 48-63) the Government contends that if this Court undertakes review of the entire records this Court will conclude that the amounts awarded exceed the fair market value. We do not believe that this Court should undertake to usurp the functions of the commission in this respect. Since this Court should review the district judge to see if *he* erred in carrying out his primary function to review the commissions' findings and award, and to see if he erred in resolving the *issues presented by such objections* (See *United States v. Lewis supra*), we do not believe this Court should go beyond the "objections heretofore filed" which are set forth in [R. 62-76]. Since *none* of the contentions made in its Argument IV were within the ambit of these objections, and since none of these present contentions were made to the district court in its "primary review of the commissions' findings and award." (*Parks v. United States, supra*), we do not believe they are properly before this court on this appeal. This is particularly true with regard to the Government's implied request in its Argument IV that this Court review the entire record to see if the awards *exceed* this Court's opinion of fair market value. We have already pointed out that the award in the *V-R Ranch* case is well within the opinions expressed by the expert witnesses, and therefore are as stated in *United States v. Waymire, supra*, "adequately sustained by evidence in respect to amount and therefore are not subject to attack for excessiveness."

Although we do not believe that the contentions made by the Government in its Argument IV are properly before this Court on this appeal, we will nonetheless briefly respond to these contentions, lest it be argued that by not responding we concede they have any merit. We do not believe they have.

On page 48 of its brief the Government makes this statement:

“Indeed, all of this evidence was inadmissible because of the failure to lay a proper foundation.”

This is so sweeping a statement that is meaningless. What is meant by all of “*this evidence?*” We do not feel that the Government has the right to complain on this appeal to the *admissibility* of any evidence to which a timely objection was not made upon its offer into evidence, and the admissibility of which was submitted to the district court. In our answer to the Government’s Argument IIIC, regarding the contention that the sales relied upon by the Commissions were irrelevant and noncomparable, we have already set forth our position in full and respectfully refer this Court thereto. The Government cannot point to a single bit of evidence, oral or written, to which a timely objection was made, overruled by the commission, and such ruling submitted to the district court. In the absence of such a showing the admissibility of any evidence is not properly before this Court for review.

**A. Answer to Government’s Argument IVA (Govt. Br. pp. 48 to 57) That the Judgments Are Not Based on Evidence Indicating Fair Market Value.**

In its Brief, page 48, the Government makes the flat statement that the commissions’ findings represent the adoption by the commissions of the *theories* urged by the landowners, and with the exception of severance

damages, the awards are “fairly close” to the landowners claims. So far as the *V-R Ranch* is concerned we only wish this statement was true, but unfortunately, it is not. As we have pointed out previously the award of \$1,163,400.00 [R. 51] is \$1,158,600.00 *less* than our high opinion value of \$2,322,000.00 and \$853,000.00 less than our low opinion. We hardly think this is “fairly close” to the landowners’ claims. The award on the contrary is much *closer* (by \$593,200.00) to the high opinion of the government witnesses which was \$598,000.00. If the term “fairly close” is applicable, it applies to the Government claims and not to those of the landowners. The Government made what were, in effect, the same contentions, *i.e.*, that commissions’ findings represent the adoption by the commissions of the theories claimed by the landowners, when they argued on the previous appeal that the finding of the commission represented adoption *in toto*, except for the amounts awarded, of proposed findings submitted by the landowners. In our response to that contention we pointed out in detail in our answering brief that this just was not so. What we said there applies with equal cogency to the present contention that the commissions’ “findings represent” the adoption by the commissions of the theories urged by the landowners.” What we stated on pages 32-34 of our Answering Brief in the previous appeal is included in Appendix “C” to this brief.

Of course some of the landowners’ “theories” were adopted—for example that the *V-R Ranch* had sufficient water resources to support a residential subdivision development on 321 acres and the other highest and best uses found for the other classifications. [See



Finding 11, R. 30-32; Finding 12, R. 32-33, Finding 13, R. 34-35], but these water findings are not under attack on this appeal.

On the patently untrue statement that the awards are “*fairly close*” to the landowners’ claims, we respectfully point out that on, for example, the opinions of value of the part taken [CR. 17—826.06 Acres] including all the improvements, were as follows:

Landowners’ Witnesses:

Ralph B. Nunnelley	\$1,919,000	[Deft. Ex. 2 “W,” Tr. 765].
George S. Mann	\$1,754,000	[Deft. Ex. 3 “D,” Tr. 1265].
Jerry B. Carll, Sr.	\$1,707,065	[Deft. Ex. 3 “F,” Tr. 1684; see Appendix “B”].

Government Witnesses:

Bernard G. Evans	\$ 563,900	[Pltf. Ex. 8, Tr. 2369].
Laurence Sando	\$ 587,000	[Pltf. Ex. 51, Tr. 3759].

Commissioners

Award	\$1,104,900.00	[R. 52].
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Thus it can be seen that the award rather than being “*fairly close*” to the landowners’ claims was \$814,000.00 *less* than the landowners’ high claim and only \$517,900.00 higher than high appraisal of the Government appraisers [see Pltf. Ex. 51—Tr. 3759]. Since the award is closer to the high appraisal of the Government by almost \$300,000.00 than to the landowners’ high appraisal, it is difficult to see how the Government can make the statement that the commission adopted the landowners’ theories and that the awards are “*fairly close*” to the landowners’ claims (Govt. Br. p. 48).

In view of the cold arithmetic of the matter, when the Government says in its brief that the commission rejected all the Government’s sales, that the findings represent an adoption by the commission of the “theories”



urged by the landowners and that the awards are “fairly close” to the landowners’ claims, we are inclined to wonder if the Government is talking about the same law suit we are. A brief comparison between Defendant’s Exhibit “2W”—Ralph B. Nunnelley’s Opinion Chart [Tr. 765] and Defendant’s Exhibit “3D”—George S. Mann Opinion Chart [Tr. 1265] on the one hand and the 13 classifications of land [Finding 10—R. 24-30] and highest and best use [Finding 18—R. 43-45] found by the commission in its report, on the other hand, will show that it is *not* true that the “commissions’ findings represent the adoption by the commission of the theories urged by the landowners.” It is clear, however, that on the issue of the water resources available to *V-R Ranch* property the commission found in Finding 11 of the report [R. 30-32] sufficient water for the highest and best uses found and that this finding is contrary to the *assumption* upon which the Government appraisers based their opinions of highest and best use and value. These water findings are not under attack on this appeal. They alone are sufficient in themselves to account for the difference between the award and the value opinions expressed by the Government experts.

We are not in a position to respond to the Government’s review of the *Battin* record set forth on pages 49 to 53 of its brief, and the *Banning* and *Dunshee* cases set forth on pages 53 to 55 of its brief because we do not have these records available. We would, however, like to call the Court’s attention to the fact that the “Mr. Carll” referred to as testifying for the landowners in those cases is not the *Jerry B. Carll, Sr.*, who testified in the *V-R Ranch Co.* case. Mr. Jerry Carll, Sr., is the *son* of the Cloice Carll who testified

in the *Battin*, *Benning*, and *Dunshee* cases, and the qualifications, background, and investigation of Mr. Jerry B. Carll, Sr., is set forth in Defendant's Exhibit "U" [Tr. 61] as are the qualifications of the other witnesses who testified for V-R Ranch Company.

We do, however, wish to comment upon that portion of the Government's Argument IV A, set forth on pages 55 and 56 of its brief with regard to the testimony of Mr. Jerry B. Carll, Sr., and Mr. Sando.

As far as Mr. Jerry Carll, Sr., is concerned, the testimony cited on page 55 of the Government's brief is only a small portion of his testimony and taken out of context.

As far as the testimony of Mr. Sando, one of the Government's appraisers, is concerned, his low appraisal was based primarily on two *assumptions*, neither of which were accepted by the commission. These two assumptions were:

(1) that the *V-R Ranch* property did not have sufficient water resources available to it to support a subdivision development, and that it had only a "limited water supply" [Tr. 3530, lines 21-25].

The commission found there were sufficient water resources available to provide for development of the property to the uses and purposes set forth [Finding 11—R. 30-32], and that these uses included the highest and best use found for the 321.03 acres in Classification No. 1 "for the development and for use as a residential subdivision" [Finding 18a—R. 43].

(2) The second assumption made by Mr. Sando was that the area of the *V-R Ranch* property was not, *in his opinion*, economically ripe for subdivision [except

over a period of years in 20 acre increments—Tr. 3530]. Mr. Sando came to this conclusion by looking to the *past history*, and not the future probabilities, of the area. What he did was to take the 11 year period prior to the taking (*i.e.*, 1947 through 1957) where 20 acres per year had been subdivided and projecting this rate of growth into the period following the taking in 1957, came to the conclusion that it would take “many, many decades” for the area to develop. For example, he testified on page 3524, lines 1 to 4:

“I found that in that entire area that in 11 years, 1947 through ’57 that there had been approximately 200 acres subdivided which is an average of 18 acres per year, and that they averaged about 36 lots per year.” Based on the foregoing reasoning, Mr. Sando concluded:

“With a population of 15,000 people in the area, there will be many, many decades, and scores of years before a great deal of this land is absorbed into subdivision use.” [Tr. 3530, lines 12-15].

And further stated:

“I think some of the reasons for lack of subdivision use, while the land is physically useable for subdivision purposes, the lack of population, the lack of industry in the area and the limited water supply I think are contributing factors.” [Tr. 3530, lines 21-25].

The commission, based on overwhelming evidence to the contrary, did not agree with his dismal view of future potential of the area [see Finding 5—R. 13-20]. They likewise did not agree with his concept of “limited water supply.” [see Finding 11—R. 30-32; Finding 12—R. 32-34; Finding 13—R. 34-35]. Mr.

Sando did not even consult with the government water expert, Max Bookman, in evaluating the water supply to *V-R Ranch* [Tr. 3795, lines 10-16], and his opinion that there was a limited water supply was based on only one of the 9 water resources [Finding 11—R. 30-32] namely, the 340 acre foot capacity of Deep Cat Lake [Tr. 3795, lines 17-25].

Furthermore, the fallacy of projecting the growth rate of 1947 through 1957 into the future was apparent from his testimony on cross-examination, to the effect that as of the dates of the sales in Conejo Valley (June 1955 to June 1957) there were 15,000 to 20,000 acres in Conejo Valley, compared with about 11,000 acres in Coyote-Santa Ana Valley, and that 80% of the Conejo acreage was vacant prior to 1954. That the rate of absorption in Conejo Valley for period prior to 1955 was very low, and at the rate of absorption that occurred in the 11 years preceding 1955, it would take scores and decades to absorb the land in Conejo Valley [see Tr. 3900, line 16, to 3904, line 10]. Yet it was apparent that most of the acreage in Conejo Valley was subdivided fully when the commission examined it in December, 1959. The sales occurred between June 1955 to June 1957 [see 19 Series Sales dates—pp. 78 to 85—Appendix “C” to government brief].

Thus the commission with justification did not find the highest and best use of residential subdivision on portions of *V-R Ranch* property from the *past history*, as Mr. Sando did, but from “reasonable future probability in light of the history of the region in general in its transition from agricultural to residential character”, as this Court stated is proper (*United States v. Lewis*, 308 F. 2d 461).



This method used by Mr. Sando of trying to find highest and best use by projecting *past history* into the future is shown to be wrong by this Court on the prior appeal, where the Court stated:

*“The highest and best use is not found from the past history or present use of these lands but from reasonable future probability in light of the history of the region in general in its transition from agricultural to residential character. \* \* \*”*  
(*United States v. Lewis* (1962), 308 F. 2d 453, 461).

In effect, what the Government is asking this Court to do is to usurp the function of the commission to weigh the testimony of the various witnesses. The witnesses differed in their opinions of the highest and best use of the lands and upon the *reasonable future probabilities*, and after hearing all the witnesses, examining all the sales and all the exhibits, the commission came to its own conclusion, which is amply supported by the evidence. Mr. Sando, based on his two assumptions of not sufficient water and projecting past subdivision activity into the future, neither of which assumption was soundly based, expressed his opinion of just compensation at \$598,000.00 [Pltf. Ex. 51—Tr. 3759-3765]. Mr. Jerry B. Carll, Sr., expressed his opinion of \$2,016,475.00 [Deft. Ex. “3F”—Tr. 1681-1684—Appendix “C”]. Both witnesses testified at great length in support of these opinions. Mr. Sando’s testimony covers 512 pages of the transcript [direct examination—Tr. 3491-3781; cross-examination—Tr. 3782-3904] and Mr. Carll’s testimony covers 436 pages of transcript [direct examination—Tr. 1666-1907; cross-examination—Tr. 1908-2077; and re-direct examination—Tr. 2078-2103].



The commission, after hearing all the testimony, both oral and documentary, including two other valuation witnesses for the landowner (Mr. Ralph B. Nunnelley and George S. Mann), and one other witness for the Government (Bernard G. Evans), and having viewed the property and alleged comparable sales of both parties, did not accept either Mr. Jerry Carll's or Mr. Sando's opinions entirely, but came to its own conclusion of just compensation of \$1,163,400.00 [R. 51]. The Government now, based on fragmentary excerpts from the transcript of the testimony of Mr. Jerry Carll and Mr. Sando, is asking this Court to say that the commission's report is "clearly erroneous" because the commission did not agree one hundred percent with Mr. Sando. We respectfully submit that this Court should not attempt to do so, but should review the district judge in light of his resolution only of the issues raised in the objections.

In *Cunningham v. United States* (1959—4th Cir.), 270 F. 2d 545, 549, the court said:

"[2, 3] This is not to say there were no conflicts in the evidence. Some witnesses thought not more than 100 acres were really suitable for subdivision. The testimony of others supports the commission's findings. If the dubious references are eliminated, the preponderance of testimony supports the findings of the commissioners. *They heard and saw the witnesses. What may be uncertain to us from reading the transcript was plain to them.* They also clearly examined the land themselves and compared Tract A with other developed areas on the island. Under these circumstances, Rule 53(e)(2) of the Federal Rules of

Civil Procedure, made applicable here by Rule 71 A(h), 28 U.S.C.A., requires acceptance of the findings of the commission.” (italics added).

And it was stated in *Rapid Transit Co. v. United States* (1961—10th Cir.), 295 F. 2d 465 at 467:

“Since the award was well within the range of credible testimony, this court will not reweigh the conclusions or retry the facts.”

And in footnote 3, page 467, the court in the *Rapid Transit* case said:

“The report of the commissioners indicated that a personal view of the lands had played an important part in arriving at what constituted a proper award. The weight to be given to this factor as against opinion evidence is exclusively for the trier of the facts.”

We believe that the foregoing rules apply very clearly to the instant situation.

Returning to the Government’s brief, the statement made on page 56 that; “Only an economic idiot would pay the same price for land in the rural Casitas Valley as he would for land near Santa Barbara or Carpenteria or in the then developing area near Moorpark and Thousand Oaks,” is an outrageous statement. The *V-R Ranch* lands were infinitely more beautiful and desirable than any of the lands in the areas to which the Government refers, and as the commission states so aptly:

“There are few areas in as close proximity to the metropolitan areas of Southern California having as desirable a climate, scenic attributes, and general cultural environment as the subject parcel had.” [R. 20].

And again:

“7. The Commissioners find that the buyers in these other areas [such as Conejo and Thousand Oaks—see Finding 6—R. 20] were acquiring lands for similar and comparable uses in areas having a climate, scenic beauty, water supply and general environment less favorable than that of the subject parcel.” [R. 20-21, portion in brackets added.]

Thus, the commission found that so far as climate, scenic beauty, water supply and general environment, *the V-R Ranch* property was better than Conejo, and since there were buyers actually acquiring said lands for the same or similar uses as the subject property, and this remark about economic idiots has a hollow ring.

If the Government seeks to infer that the commission did not consider all factors of comparison, including economic ripeness for subdivision, they are likewise mistaken. The demand in the area is fully covered in Finding 5 [R. 13-20]; Finding 6 [R. 20]; and Finding 7 [R. 20-21] of the report. Among other findings, the commission found specifically:

“Properties in Ventura County and in the area of CR 17 were at the time of the take *greatly in demand* because, among other things, a large number of people of retired status were seeking country life on either residential subdivisions, or country estates, or rural ranches, or estates with or without avocado, citrus and deciduous trees either in family orchard size or in [387] small or large commercial developments.” [R. 18—italics added].

If the Government seeks to infer that the commission assigned to the 321 acres of *V-R Ranch* land that had a highest and best use for development and use for residential subdivision, the same price per acre as these other sales they are equally wrong—unfortunately for Appellee. As we pointed out earlier, Mr. Jerry Carll, Sr., relied on four sales in placing an opinion of \$3,100 per acre on the 321 acres in Classification No. 1. These sales were 22-1—\$3,176.00 per acre; 23-5—\$3,225.00 per acre; SB-1—\$3,358.00 per acre; SB-2—\$2,893.00 per acre [see Deft. Ex. “3F,” Tr. 1684; Appendix “B”]. These four sales average \$3,188 per acre, and this price multiplied by the 321 acres would amount to \$1,023,348.00 for the 321 acres alone, but the commission only awarded \$1,104,900.00 for the entire 826 acres taken (including the extensive ranch improvements valued by witnesses from both sides at from a minimum of \$139,000.00 to a maximum of \$210,000.00). Subtracting the 321 acres of potential residential subdivision land from the total 826 acres, this leaves 505 acres, including all of the lands described in Classification 2—154.26 acres with highest and best use for development to rural homesites [Finding 18(b)—R. 43]; 38.52 acres in Classification No. 3 with highest and best use for development for view-type country estate or estates [Finding 18(c)—R. 43]; the 67.60 acres of creek bottom land [Finding 18(e)—R. 44]; the 12.06 acres in Classification 7 with highest and best use as a dude ranch or ranch home [Finding 18(g)—R. 44]; the 107.59 in Classification No. 8 with highest and best use for large acreage estates [Finding 18(i)—R. 45]; and many others.



So it is clear, beyond any question, that the commission did *not*, as the Government seems to imply from their "economic idiot" remark, assign to the 321 acres of potential residential subdivision land of *V-R Ranch* the same price per acre as subdivision land was bringing "for land near Santa Barbara or Carpinteria or in the then developing area near Moorpark and Thousand Oaks". It is also perfectly clear that the commission based its values upon the economic situation and the state of development (as well as the reasonable future probability of development) of the Santa Ana and Coyote Valleys at the date of the taking.

**B. Answer to Government's Argument That There Are Duplications and Contradictions of Value in Substantial Amounts.**

In its Argument IVB on page 57, the Government says "There is every reason to believe that there are duplication (*sic*) and contradiction of values in substantial amounts." On the contrary, an examination of the *V-R Ranch* report shows there is no duplication and there is no "contradiction" (whatever that means) of value.

*1. Lands classified as protective fringe areas:*

*(Govt. Br. IVB-1, p. 57)*

The Government says "The reports of the commission do not exclude such duplication," but the *V-R Ranch* report clearly shows there was no such duplication. Based upon the assumption that "the commissions accepted the landowners' theories here, just as they did on future subdivision values," the Government argues that there must be a duplication of values.

An examination of the *V-R Ranch* report shows that the only lands falling into the highest and best use as



protective fringe area consist of 32.56 acres out of the larger parcel of 1,594 acres [of which CR. 17—826.06 acres, the part taken, was a part only] [R. 25]. These 32.23 acres are the following:

12.23 acres—Classification No. 4—[Finding 18(d), R 44]. This Classification No. 4 is described in Finding 10 (d), R. 27, as follows:

“(d) Classification No. 4. An area of 12.23 acres consisting of sloping to relatively steep lands between said Coyote Creek and the lands hereinafter described as Classification No. 9.”

10 acres—Classification No. 6—Finding 18(f), R. 44. This Classification No. 6 is described in Finding 10(f), R. 28, as follows:

“(f) Classification No. 6. An area of 10 acres comprised of rough, steep lands, the only utility of which would be as protective fringe lands in the event of a development of a dam at the area referred to herein as ‘Dunshee Narrows’ or ‘Dunshee Dam Site.’ ”

10.33 acres—Classification No. 10 [Finding 18(j), R. 45]. This Classification No. 10 is described in Finding 10(j) [R. 29], as follows:

“(j) Classification No. 10. An area of 10.33 acres constituting a peninsula lying between the Coyote Creek bottom land [396] and the 16.50 acres referred to as ‘Proposed Lake No. 2.’ ”

And in ascribing a highest and best use to these 10.33 acres in Classification No. 10, the commission found *alternative* uses, saying in Finding 18(j) [R. 45]:

“(j) The area of 10.33 acres, referred to hereinabove as Classification No. 10, has a highest and

best use as protective fringe and approachway to the western portion of Classification No. 1. *The lands comprising this area would also have a use as an alternative approach to the area lying west of Coyote Creek and could be used not only for clubhouse purposes, but for access to these lands.*" (Emphasis added.)

Since the 10.33 acres in Classification No. 10 has alternative uses and must be valued in consideration of all uses, it does not come in the category of "protective fringe areas." This leaves only 12.23 acres in Classification No. 4 and the 10 acres in Classification No. 10 in the category of "protective fringe areas"—or 22.23 acres out of nearly 1,600 acres in this category. Since the 10 acres in Classification No. 6 is described by the commission as "rough, steep lands, the only utility of which would be as protective fringe lands in the event of a development of a dam in \* \* \*," the Dunshee Dam Site, it is clear the commission put little if any value on it. Jerry B. Carll, Sr., was of the opinion it was worth only \$50.00 per acre [See Ex. "3F," Tr. 1684, Appendix "C"], and the lowest values the Government appraisers put on *any* of the *V-R Ranch* land was \$100.00 per acre [See Pltf. Ex. 8—Tr. 2369, Evans' chart; and Pltf. Ex. 51—Tr. 3759, Sando chart]. It is clear that so far as *V-R Ranch* property is concerned, this is much ado about nothing. Besides, the landowners' witnesses made it quite clear they made no duplication of values on the protective fringe land.

2. *The improvements on the V-R Ranch property.*  
(Govt. Br. IVB-2, p. 60)

The Government argues that one of the landowners' witnesses, Mr. Jerry B. Carll, Sr., reflected the value

of the improvements in the 12.06 acre in Classification No. 7, "Headquarters Area," in the value of the land and also added to the total land values the value of the improvements. As we shall show, this is *not* true. Based on this false premise, the Government argues that there is every reason "to suppose the commission likewise followed his valuations" (Govt. Br. p. 62). We only wish they had followed Mr. Carll's valuations and then the award would have been \$2,016,475.00 instead of \$1,163,400.00. How the Government can keep saying that the commission followed Mr. Carll's valuations when the award is \$853,075.00 *lower* than his opinion, we cannot understand.

*In the first place* this contention was not made to the district judge. The *only* objection referring to Classification No. 7 was the Government's Objection 24 [R. 72] to the effect that the finding that this 12.06 ac. area had a highest and best use as a dude ranch or as a ranch home is, *insofar as it relates to the use of the area for a "ranch home"* was not supported by the evidence since no witness in the case testified to such a use. This is the *only* objection relating to this area that was presented to and argued before the district judge. We pointed out to the district judge, in answer to the *issue based by this objection*, first, that the main house in this area is a ranch home, and is described fully in Defendant's Exhibit "S" [Tr. 59].

We also pointed out that all the witnesses testified to a variety of uses. See for example Jerry B. Carll Sr., who said it could be used as the "development headquarters" [Tr. 1707, lines 9-25] and referred to it as the "main house such as ranchers build" [Tr. 1734,

lines 8-23] and that the “developer may live in it” [Tr. 2059, lines 16-22]. Furthermore Government witness Bernard Evans testified the highest and best use for the *V-R Ranch* property was for a stock ranch or a dude ranch. [Tr. 2159, line 11, to 2160, line 15], and Mr. Sando referred to it as the “main ranch house,” [Tr. 3543, line 22 and 3548, lines 15-20].

*Now, for the first time on this appeal the Government argues a duplication occurred.*

In its statement on page 61 of its brief to the effect that the small tract of 12.06 acres in Classification No. 7 (which the commission found had a highest and best use as a dude ranch or as a ranch home [R. 44]) that no one would pay \$4,000 an acre for the land and \$141,000 up to \$210,000 for the improvements, shows that the Government misses the entire point of the breakdown. Mr. Carll (as did all the witnesses, including those of the Government) valued the entire area of 1594.52 acres *before* the taking and his opinion of \$2,107,000.00 is the total value of the 1594.52 acres as improved is set forth in his Chart No. 1 [Ex. “3F”—Appendix “B”]. In his *breakdown* of this figure he felt that the land (1594.52 acres) contributed \$1,965,674 [see p. 6 of Ex. “3F”—Appendix “B”] and that the specific improvements listed on page 7 of Exhibit “3F” contributed \$141,400 to the total value of the entire 1594.52 acres and that the total “Fair Market Value of 1594.52 Acres Considered as A Whole, and as Improved in August 12, 1957; and Before the Taking,” was \$2,107,073 [see p. 7—Chart No. 1, Ex. “3F”—Appendix “B”]. He then found the value of the remaining 768.46 acres after the take at \$90,525.00 as set forth on Chart No. 2 of Exhibit “3F.” The *dif-*



ference between the whole before and the remainder after is \$2,016,475 representing his opinion of the total just compensation. This is precisely in accord with the law and precisely as all the other witnesses testified. Mr. Carll's Chart No. 3 is his *breakdown* of the value of the part taken Cr. 17 as of August 12, 1957. The difference between this figure of \$1,707,065 and the total just compensation of \$2,016,475 is severance damages. The \$4,000 per acre contribution of the 12.06 acres in Classification No. 7 is Mr. Carll's opinion of the contributive value of these level, landscaped and otherwise developed *lands* to the whole before the take. An analysis of the various charts of the witnesses is set forth, for the convenience of the court in Appendix "G" to this brief.

But in the second place, it is perfectly clear that Mr. Carll did *not* reflect the value of the structures described in the seventh page of his valuation chart [Ex. "3F", Tr. 1684, Appendix "B"].

Mr. Jerry Carll testified as follows, page 1720, line 13 to 1730, line 1:

"Q. You have been referring to Exhibit 'H' by reference in Exhibit 'Y' in this case. All right, sir. Now will you then turn to your Chart No. 1 of Exhibit '3F' on page 7 of said chart. What does that purport to be, sir? A. That is my opinion of the contribution of the improvements on the amount of value of the improvements contributed to by the whole.

Q. You have a total of the items listed of \$141,400.00. A. Yes.

Q. That is your opinion of the total value contributed to the whole by the improvements. In



other words, enhancement of value by reason of these *specific improvements that you have listed*.

A. Yes sir, \$141,400.00.” (Italics added.)

On the issue of possible duplication of values on the ranch improvements, Mr. Carll, in discussing his sale 23-5, stated that the land in the headquarters area (12.06 acres in Classification No. 7) was more highly developed than the land in Sale 23-5 [Tr. 1867, lines 16-20] and the following occurred on page 1869, line 18, to page 1870, line 25 of the transcript:

“Commissioner Whelan: You mentioned the headquarters area that you compared the subdivisible land of Sale 23-5 to the headquarters area which I believe you assigned a contributive value to your opinion of fair market value of \$4,000.00 an acre.

The Witness: Yes, sir.

Commissioner Whelan: In your testimony you stated that the improvements on the headquarters area were of much more value than \$4,000.00 an acre.

The Witness: Yes, sir.

Commissioner Whelan: In your testimony you stated that the improvements on the headquarters area were of much more value and of finer nature than of any improvements in Sale 23-5, I believe that was in substance what you stated.

The Witness: Yes.

Commissioner Whelan: Did you ascribe any added value to the land within the headquarters area because of the presence of the improvements thereon?

The Witness: Well, when talking about the improvements this attached to the land, like landscaping and . . .

Commissioner Whelan: Water piping?

The Witness: Water piping and walks and little walls.

Commissioner Whelan: Not the buildings.

The Witness: Not the buildings.

Mr. Anson: The buildings that total \$141,400 are not the improvements you are talking about now?

The Witness: No sir, I am talking about the part that is attached to the land.

Mr. Anson: Over and above and in addition to the items listed on your Chart No. 1?

The Witness: Yes, over and above on page 7.

Q. Page 7 of your chart. All right, that clarifies it."

In regard to this Classification No. 7, the commission described this area as follows:

"(g) Classification No. 7. An area of 12.06 acres referred to in some of the testimony herein as either 'Headquarters Area' [395] or 'Dude Ranch Area,' comprised of *level*, highly developed lands upon which are located the following-described ranch improvements: [Main ranch house], domestic water lines supplied from nearby springs and other improvements, [a duplex,] [foreman's house and office,] [guest house,] [bunk house,] [ranch kitchen,] [dining room] and [apartment,] [horse barn and corrals,] [dairy units] and [milkers' house,] [work shop,] [butcher house,] [hay barn,] [hay shed,] [scale house] and [cat-

tle pens,] [tool shed,] [filling station] and other minor improvements, including roads, fences, underground piping, cattle guards, and so forth. That said improvements at the date of said take constitute a unit for agricultural products, and a dairy, cattle and dude ranch. That in addition to the foregoing improvements, the said parcel CR 17—826.06 acres—included an irrigation system—permanent and mobile—water distribution system, concrete pipe basins and concrete watering troughs, fire hydrants, sprinkler outlets, etc.” [R. 28-29. brackets and italics added.]

Those portions of the improvements above listed which we have placed in brackets are the only structures which are listed on Mr. Carll’s breakdown of the improvements which contributed \$141,400.00 to value of the whole. On the seventh page of his opinion chart [Deft. Ex. “3F”, Tr. 1684, Appendix “B”] Mr. Carll listed fifteen structures which in the breakdown of his opinion of value was the “total value contributed to the whole by improvements, \$141,400”. In *addition* to the contribution of \$141,400.00 to the value of the whole 1594.52 covered by this portion of his total valuation chart, Mr. Carll pointed out that the 12.23 acres in Classification No. 7 was otherwise *level* and highly developed land and using that portion of his testimony cited on page 61 of the Government’s brief stated:

“By that I mean landscaping, fencing, water reservoirs, piping, swimming pool excavations \* \* \* .” [Tr. 1707].

It will be noted that not one single structure listed separately on page 7 of his Exhibit “3F” [Tr. 1684,

Appendix "B"] as contributing \$141,400.00 to the value of the whole 1594.52 acres is included in the landscaping, fencing, water reservoirs, piping, swimming pool, excavations, which he said was what he meant by "highly developed land". It will be noted that in addition to the *structures* included in Mr. Carll's \$141,400.00 improvement schedule, and placed in brackets by this brief writer in the above commission description of Classification No. 7, the commission found in addition to these listed structures:

"\* \* \* and other minor improvements, including roads, fences, underground piping, cattle guards, and so forth."

It is perfectly clear that when Mr. Carll referred to the 12.53 acres in Classification No. 7 as "highly developed *land*", he was referring to these improvements *other* and in addition to the fifteen structures listed on page 7 of Exhibit "3F", which fifteen structures in his opinion *breakdown* contributed \$141,400.00 to the value of the whole. Mr. Carll testified that he did *not* duplicate any of the value of the improvements listed on his Chart No. 1—[Deft. Ex. "3F"—Appendix "B" to this brief].

He said so clearly and unequivocally. In addition, an analysis of his \$4,000.00 per acre opinion of the value of the 12.06 acres in Classification No. 7 shows clearly that he did *not* and could not have reflected value of the fifteen structures listed on page 7 of his Exhibit "3F" in the value of the land. Mr. Carll valued the land in Classification No. 1 at \$3,100.00 per acre based on Sale 22-1 at \$3,176.00 per acre, sale 23-5 at \$3,225.00 per acre, sale SB-1 at \$3,358.00 per acre, sales SB-2 at \$2,893.00 per acre, which is an average



for the four sales of a sale price of \$3,188.00 per acre for *unimproved* land [see Ex. “3F”, Tr. 1684; App. “B”]. The area of 12.06 acres in Classification No. 7, Mr. Carll valued at \$4,000.00 per acre, using sale 23-5 at \$3,225.00 per acre, sale 23-7 at \$3,996.00 per acre, and sale SB-1 at \$3,558.00 per acre. It can be seen that these three sales average about \$3,560.00 per acre. The lands in the 12.06 “Headquarters” area in Classification No. 7, at a value (in Mr. Carll’s opinion) of \$4,000.00 per acre, is a mere \$440.00 per acre more than the value indicated by these sales. Mr. Carll carefully explained that *in addition* to the fifteen structures which in his opinion contributed \$141,400.00 to the value of the whole:

“This is highly developed land. *By that I mean* landscaping, fencing, water reservoirs, piping, swimming pool excavations \* \* \*.” [Tr. 1707—*Italics added*].

Thus, Mr. Carll felt that the 12.06 acres in Classification No. 7 had a value of only \$440.00 per acre more than the \$3,560.00 average sales price of the three most helpful sales (23-5, 23-7, and SB-1), and these lands in Classification No. 7 had roads, cattle guards, landscaping, underground piping, fencing, water reservoirs, and swimming pool excavations, *in addition* to the fifteen structures which contributed \$141,400.00 to the value of the whole 1594 acres.

Therefore, it is clear that Mr. Carll did *not* duplicate any values. The other landowner appraiser, Mr. Mann, likewise placed a value of \$4,000.00 per acre on this land, and there is no contention that he duplicated any values [See Deft. Ex. “3D”, Tr. 1265].



Besides, the Government appraisers handled the improvements in exactly the same manner as Mr. Carll [see *Sando* Pltf. Ex. 51, Tr. 3759; and *Evans* Pltf. Ex. 8, Tr. 2369]. In his *breakdown* of the fair market value of the part taken, Mr. Sando included an item of “Improvements as itemized and described, \$139,000.00, and Mr. Evans, after placing a value on various categories of the land, included in his *breakdown* an item reading: “Add: Improvements \$142,000”. The *structures* which Mr. Evans and Mr. Sando included in their lists were virtually identical with those of Mr. Carll [see lists in back of Deft. Ex. “S”, Tr. 59].

3. *Deep Cat Lake. (Govt. Br. IVB-3, pp. 62 to 63).*

The Government contends, on page 62 of its brief, that there was a duplication of values as regards the 17.27 acre lake on the *V-R Ranch* property.

The witnesses were asked (exactly as the Government witnesses were asked) to give a *breakdown* of their value opinions of the contributive part each category of land and improvements to the whole. This *breakdown* is given in the various charts—Deft. Ex. “2W”, Tr. 765; Deft. Ex. “3D”, Tr. 1265; Deft. Ex. “3F”, Tr. 1684; Appendix “B”; Pltf. Ex. 8, Tr. 2369; and Pltf. Ex. 51, Tr. 3759. Thus each witness on both sides who expressed an opinion of value was treated exactly the same.

Mr. Nunnelley in his classification chart listed as a separate item, Item No. 16, Deep Cat Lake, 17.27 acres to which he assigned a value contribution to the whole of \$1,250.00 an acre for a total value contribution of the land underlying the lake of \$21,587.50. When he reached this point of his testimony on direct examina-

tion the following colloquy occurred between the Commissioners and the witness, which we believe establishes that the commission did not include any duplication for Deep Cat Lake in its award. On page 773, line 15 of the Transcript the following colloquy occurred:

“Commissioner Whelan: Mr. Nunnelley, would the value of the land underlying Deep Cat Lake be represented by the enhancement in value to the surrounding lands of which it was a part rather than having a separate amount set up for it?

The Witness: I believe you are referring to—what is it—\$1,250.00?

Commissioner Whelan: Item 16.

The Witness: Item 16, I might explain my reason on that sir, is this, that the lake itself, the primary purpose of the lake is for water for the property, an additional use for the lake is its recreational area. With the filtration you have boating and fishing and such as that on it. There is an additional value in my mind as a commodity because it is a lake over and above the water supply.

Chairman Mayock: Mr. Nunnelley. Since you have chosen to value the property as enhanced by the improvements on an acreage basis or would you feel that the acreage basis should apply to the area of the dam site itself?

Mr. Anson: In other words, as I understand it—

Chairman Mayock: And in acres thereto.

Mr. Anson: Yes, you place a value on the land underlying the dam itself, the lake itself.

The Witness: Yes, there was a value placed upon the land underlying the lake.

Chairman Mayock: That is the point. The theory of your valuation here is a per acre valuation, isn't it?

The Witness: That is correct.

Chairman Mayock: And therefore it would be improper—the large acreage which was used up for the dam site would be deleted from the total of acres considered, is that right?

The Witness: Yes, sir, that is correct.

Chairman Mayock: And then you utilized Deep Cat Lake acreage which was then for the purpose of utilizing on the acreage and putting a value on it as an acreage basis.

The Witness: That is correct.

Mr. Anson: Mr. Nunnelley, if you were to eliminate from your breakdown—and this is just a breakdown of your final opinion of value—Item No. 16, \$21,587.00 and simply spread that into the subdivision lands surrounding it, you would then have to add, would you not, to the \$3,000.00 acre that you assigned to the subdivision portion?

Mr. Read: That isn't the question.

Mr. Anson: We are trying to clarify it.

Chairman Mayock: I think I am clear on the theory of his detail of contribution values to the whole. His idea is, as I see it, that he made acreage a yardstick and accounted for all of the acreage that was in the parcel on that yardstick basis.

The Witness: That was correct sir, yes sir.

Mr. Anson: Yes, and it is simply a breakdown.

Chairman Mayock: I understand—"

Mr. Nunnelley was examined fully on whether or not he had duplicated his values so far as the 17.27 acres

underlying the Deep Cat Lake was concerned. He testified categorically that he had not made such duplication, in the following testimony, starting on page 800, line 16, of the Transcript:

“Q. Then Item No. 16, Deep Cat Lake, at \$1250 an acre—I think you have already covered that haven’t you. A. That is correct.

Q. If you simply put zero there in view of the fact that it has a lake, it is an existing lake, the \$21,587.50 which you have assigned in your breakdown to that, what would you do with that? A. It would be distributed to the property as a whole, to the other acreage. It was a matter of putting it one place or another—.” [See also the full explanation, Tr. 801, line 1, to 804, line 9].

Thus there was no “double valuation of Deep Cat Lake” as far as Mr. Nunnelley was concerned. But in any event, the commission did *not* follow Mr. Nunnelley’s classifications of land (and obviously not his value opinions, since the award for the part taken [\$1,104,900—R. 52] was \$755,600.00 less than Mr. Nunnelley’s opinion), and so even if there was a duplication (which the record shows there was not) in Mr. Nunnelley’s opinion, it is clear that the commission did not include any duplication in its award.

With regard to Mr. Carll’s testimony, he testified that Classification No. 1 consisting of 338.30 (which included the 17.27 acres underlying the lake) had a contributive value to the whole part taken of \$1,048,730.00 [see Ex. “3F”—Appendix “B” to this brief]. This gave a breakdown per acre for the entire 338.30 acres of \$3,100 per acre. In his testimony on page 1977 of the transcript, Mr. Carll carefully explained that he



did not duplicate values, but that in *his breakdown charts* he sought to account, as a matter of good book-keeping for all of the acreage in the take (826.06 acres), and the larger parcel (1594.52 acres), of which the part taken was a part only. He testified as follows starting on page 1978, line 18 of the transcript:

“Chairman Mayock: Mr. Carll, what you did then was to take the total of acreage that is in I [Classification No. 1] let us say, and Deep Cat Lake is in it, isn’t it?

The Witness: Yes sir.

Chairman Mayock: And gave a value of the whole on an acreage basis.

The Witness: Yes sir.

Chairman Mayock: It could well have been expressed by taking the acreage amount of Deep Cat Lake, subtracting it from the whole and then adding it again as a value of water to the whole acreage, couldn’t it.

The Witness: Yes, that is one approach.

Chairman Mayock: And you would have come up with the same figure, isn’t that right?

The Witness: Same total contribution.

Chairman Mayock: So instead of considering Deep Cat Lake as value from an acreage standpoint as a standard, you used acres for the whole piece, is that right?

The Witness: That is entirely correct.

Chairman Mayock: I see.”

And again on cross-examination by the Government attorney, Mr. Read, the following occurred, starting on Transcript page 977, line 15:

“Q. Mr. Carll, I would like you to explain why you have ascribed a subdivision contributive value



of \$3,100.00 per acre to the Deep Cat Lake which of course would never be subdivided. A. Well, it is really very simple. If I may refer to Exhibit "3G", I didn't consider that the water appropriated, water of Deep Cat Lake could be separated and would be separated from the subdivision lands. Now, as I previously stated in direct examination, I considered that all of this subdivision land had the same amount of desirability and that the difference in price was merely the difference in cost to develop and I didn't think that this land in Deep Cat Lake could be separated from that and that when they were sold they would be attached to that land.

Q. That of course is true \* \* \*."

And finally on cross-examination with regard to this issue, the following occurred, starting on page 1882, line 17 of the transcript:

"Q. Mr. Carll, I want to be sure I understand your answers to Mr. Mayock's question concerning the contributive value of Deep Cat Lake to the whole and why you have assigned a subdivision value of \$3,100.00 to the lake bed. Is it a fair statement to say that in your opinion the 338.30 acres in your Classification No. 1 could be reduced by the amount of acreage of Deep Cat Lake (17.27 acres) which would leave 321.03 acres and a per acre contributive value reflecting the addition of the contributive value of Deep Cat Lake itself which would be—I won't bother to figure it out.

Mr. Anson: \$53,557.00.

Q. \* \* \* which could be divided among these 321.07 acres so as to increase their contribu-

tive value to the whole from \$3,500.00 to whatever the result would be after you made this?

Commissioner Whelan: From \$3,100.00 to \$3,200.00 and some, it would be not quite \$3,300.00 per acre.

Mr. Read: Is that it?

Commissioner Whelan: \$3,100.00 an acre. An assigned value on 338 acres if you spread \$3,000.00 among some 320 acres, it would be \$175.00 roughly an acre more.

By Mr. Read:

Q. That is a fair statement? A. That is the basic process, of course, you couldn't reduce the value of the land in that lake to nothing. If you are going to do that, then it has to be—every acre has to be accounted for, it would have to be in a different classification then.”

Thus it was very clear to the commission knew exactly what Mr. Carll had done, and they were not confused on this point in the slightest. Thus a comparison of the actual testimony with the findings shows the validity of that part of the statement in *Cunningham v. United States, supra*, that:

“They [the commission] heard and saw the witnesses. What may be uncertain to us from reading the transcript was plain to them \* \* \*.”

Thus Mr. Carll's testimony regarding *Deep Cat Lake* was not a duplication. But even if it had been, it is clear the commission did not include any duplication. The Government recognizes that the commission did not include the lake in the amount of acreage “listed for subdivision value” (Govt. Br. p. 63), but argues nevertheless that because it is not clear just where the com-

mission considered the lake it “*does not expressly exclude the duplication.*” We think the report clearly does expressly exclude any duplication. The thirteen categories of land to which the commission assigned highest and best uses total 1577.25 acres [a total of the acreage covered in Classification No. 1 to No. 13, inclusive, R. 24 to 30], although the commission specifically found that the larger parcel was 1594 acres, more or less [R. 25]. Thus it is clear that adding the 17.27 acres underlying the lake to the 1577.25 acres in Classifications No. 1 to No. 13, inclusive, gives a full accounting of the 1594.52 acres in the larger parcel.\* Also, although the commission adopted Mr. Carl’s Classification No. 1 as potential residential subdivision land, they carefully subtracted the 17.27 acres underlying the lake from Mr. Carl’s total of 338.30 acres in Classification No. 1 [See Deft. Ex. “3F”, Tr. 1684; Appendix “B”] and found that Classification No. 1 consisted of 321.03 acres [Finding 10(a), R. 25-26] with a highest and best use (of 321.03 acres) “for development and for use as a residential subdivision [Finding 18(a) R. 43]. This 321.03 acres is the exact total of the 214.81 acres east Coyote Creek and 106.21 acres west of Coyote Creek [See Deft. Ex. “3F”, Tr. 1684; Appendix “B”], and the 17.27 acres is carefully *not included* in the acreage found to have a highest and best use for development and for use as a residential subdivision. Despite the exclusion from the 321.03 acres of the 17.27 acres underlying the lake the commission, after stating that the 321.03 acres in its Clas-

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\*This can also be seen from Appendix A to the government brief, where after showing the total of 15,577.25 acres with highest and best uses they point out in footnote (\*\*), “In addition to this total, 17.27 acres was Deep Cat Lake [R. 25].”

sification No. 1 consists mostly of gentle sloping, rolling land, including 214.82 acres lying to the east of said Coyote Creek and 106.21 acres of land lying to the west of said Coyote Creek, specifically states:

“That lying *between* the two areas heretofore discussed was an existing lake or reservoir referred to as ‘Deep Cat Lake’ with \* \* \*, an area of 17.27 acres, and capable of storing as of the date of take approximately 338 acre feet of water. \* \* \*” [R. 25-26] (*Italics added*).

In addition to specifically excluding the lake from the potential subdivision land in Classification No. 1, the commission specifically found that the lake was a part of the water resources available to the property, listing said lake as water resource (f) in Finding 11, as follows:

“(f) That in addition to the foregoing water resources, the existing Deep Cat Lake is capable of storing, as of the date of the take, approximately 338 acre feet of water under the existing permit for the appropriation of 418 acre feet.” [R. 31.]

Thus, in answer to the Government’s statement on page 63 of its brief—“However, the report is not clear just where the commission considered the lake, if at all”—we can only suggest that the Government read the report. It is clear that the commission considered the lake exactly as they said they did “\* \* \* in addition to the foregoing water resources \* \* \*” [Finding 11 (f), R. 31-32]. We do not see how the commission could have more clearly, unequivocally and expressly excluded any duplication of the value of Deep Cat Lake.



#### ARGUMENT IV.

##### Answer to Government's Argument V That "Upon Remand" a Jury Trial Should Be Directed.

The contentions under Argument V, pages 63 to 67 of the government brief, constitute simply *another* attempt to set aside the order of the District Judge made under Rule 71A(h) of the Federal Rules of Civil Procedure. As we stated on page 26 of this brief in commenting on the Government's Specification of Error No. 11—to the effect that the District Court erred in submitting these cases to commissions under Rule 71A (h)—this contention has already been decided adversely to the Government's claims in *United States v. Hall* (1960, 9th Cir.), 274 F. 2d 856, in which case the Supreme Court denied certiorari.

We feel, for the reasons set forth herein, that no remand should be made in this case, but if such is made, and there are any inadequacies in a particular report, they must be specified by objection to the report, and if any case be remanded for correction of error in this area, it must be with instructions that by report or finding resolution of some "specific dispute be made or some specific inadequacy be remedied." (*United States v. Lewis*, 308 F. 2d 453.)

To remand these cases for a jury trial would result in a gross miscarriage of justice to these landowners and to deny them "just compensation" for their property which was taken from them back on August 12, 1957, *six years ago*.



**Conclusion.**

It is respectfully submitted that the judgment in this case should be affirmed.

Respectfully submitted,

ANSON, GLEAVES & LARSON,

By JOHN B. ANSON,

*Attorneys for Appellee,  
V-R Ranch Company.*

**Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN B. ANSON,









SUMMARY AND CLASSIFICATION OF ACREAGE SALES  
Illustrative of the Testimony of  
Laurence Sando, M.A.I. for Parcel CR-17 in Civil 974-57 PH filed 8/12/57

Sale No.	Acres	Deed Dated	Deed Recorded	Sale Price	Aver. per Acre	Price adjusted to Aug. 1957	Orchards	Irrigated	Fairly Level	Mesa or Rolling	Wooded Creek Land	Moderate Slopes or Ridges	Steep Hills or Mountainous
1	26.00	3/28/57	5/28/57	\$ 8,000	\$308	\$ 8,000 \$308 Ac.	—	—	—	<u>\$850</u> 5 Ac.	<u>\$667</u> 3 Ac.	—	<u>\$100</u> 18 Ac.
2	62.15	11/1/56	12/13/56 Imps. *Land	\$ 27,000 <u>3,000</u> \$ 24,000	\$386	\$ 26,000 \$420 Ac.	<u>\$950</u> 12 Ac.	—	<u>\$600</u> 18 Ac.	—	—	<u>\$200</u> 11 Ac.	<u>\$75</u> 21 Ac.
2A	14.88	7/10/57	8/1/57	\$ 5,000	\$336	\$ 5,325 \$355	<u>\$500</u> 8 Ac.	—	—	—	<u>\$275</u> 4 Ac.	—	<u>\$75</u> 3 Ac.
2B	55.00	4/12/57	4/19/57	\$ 13,000	\$236	\$ 13,000 \$236 Ac.	<u>\$1,000</u> 2 Ac.	—	—	—	<u>\$667</u> 3 Ac.	<u>\$160</u> 50 Ac.	—
4	60.00	5/8/56	7/24/56	\$ 12,000	\$200	\$ 13,000 \$217 Ac.	—	—	<u>\$825</u> 4 Ac.	—	—	<u>\$225</u> 33 Ac.	<u>\$100</u> 23 Ac.
5	183.00	6/23/53	9/14/53 Imps. Land	\$115,000 <u>20,000</u> \$ 95,000	\$519	\$140,500 <u>20,000</u> \$120,500 \$658	—	<u>\$1,500</u> 8 Ac.	—	<u>\$775</u> 80.0 Ac.	<u>\$600</u> 60 Ac.	<u>\$300</u> 35 Ac.	—
7	26.73	4/18/55	5/5/55 Imps. Land	\$ 23,500 <u>3,500</u> \$ 20,000	\$750	\$ 26,500 \$991 Ac.	<u>\$1,250</u> 10 Ac.	—	<u>\$900</u> 12 Ac.	—	<u>\$634</u> 4.73 Ac.	—	—
12	47.82	2/28/57	3/19/57 Imps. Land	\$ 50,000 <u>10,000</u> \$ 40,000	\$836	\$ 40,000 \$836 Ac.	<u>\$2,000</u> 2.5 Ac.	—	<u>\$600</u> 30.00 Ac.	<u>\$1,000</u> 15.32 Ac.	—	—	—
16	68.16	2/10/56	3/1/56	\$ 57,000	\$838	\$ 64,750 \$950 Ac.	—	<u>\$2,000</u> 2.82 Ac.	—	<u>\$960</u> 60.10 Ac.	—	<u>\$300</u> 5.24 Ac.	—
17	824.90	5/21/57	5/29/57 Imps. Land	\$190,000 <u>25,000</u> \$165,000	\$200	\$165,500 \$200 Ac.	<u>\$1,500</u> 20 Ac.	<u>\$1,200</u> 10 Ac.	—	<u>\$500</u> 100 Ac.	<u>\$300</u> 20 Ac.	—	<u>\$100</u> 675 Ac.
27	188.00	10/11/56	11/30/56	\$ 35,000	\$186	\$ 37,600 \$200 Ac.	—	—	—	<u>\$850</u> 25 Ac.	—	—	\$100

\*Option on 11/1/56



## Appendix "A" (Cont.)

SUMMARY AND CLASSIFICATION OF ACREAGE SALES  
 Illustrative of the Testimony of  
 Laurence Sando, M.A.I. for Parcel CR-17 in Civil 974-57 PH filed 8/12/57

Sale No.	Acres	Deed Dated	Deed Recorded	Sale Price	Aver. per Acre	Price adjusted to Aug. 1957		Orchards	Irrigated	Fairly Level	Mesa or Rolling	Wooded Creek Land	Moderate Slopes or Ridges	Steep Hills or Mountainous	
30	20.91	3/23/56	5/7/56	\$ 24,500	\$1,172	\$ 27,000	\$1,291	—	—	—	<u>\$1,291</u> 20.91 Ac.	—	—	—	—
31) 32)	25.19	2/12/55	4/18/55	\$ 19,500	\$774	\$ 23,400	\$930	—	—	—	<u>\$1,200</u> 18 Ac.	—	<u>\$250</u> 7.19 Ac.	—	—
33	20.78	3/27/56	4/20/56	\$ 16,000	\$770	\$ 18,000	\$866	—	—	—	<u>\$866</u> 20.78 Ac.	—	—	—	—
34	493.79	3/14/56	4/18/56	\$ 49,370	\$100	\$ 57,000	\$115	—	—	—	—	<u>\$315</u> 75 Ac.	<u>\$190</u> 127 Ac.	<u>\$80.00</u> 37.57 Ac.	<u>\$25.00</u> 254.22 Ac.
35	78.69	2/11/55	6/8/55	\$ 12,000	\$150	\$ 15,750	\$200	—	—	—	—	—	<u>\$200</u> 78.69 Ac.	—	—
36	131.00	9/19/55) 3/2/56)	9/27/55) 3/30/56)	\$ 90,000	\$687	\$104,800	\$800	<u>\$1,400</u> 29 Ac.	—	<u>\$860</u> 60 Ac.	—	—	<u>\$300</u> 42 Ac.	—	—
36a	25.82	2/8/57	3/7/57	\$ 33,000	\$1,300	\$ 33,000	\$1,300	<u>\$1,750</u> 10 Ac.	—	<u>\$1,200</u> 11.82 Ac.	—	—	<u>\$325</u> 4 Ac.	—	—
38	39.00	2/20/56	3/6/56 Imps. Land	\$ 65,000 15,000 <u>\$ 50,000</u>	\$1,282	\$ 69,600 15,000 <u>\$ 54,500</u>	\$1,400	—	—	<u>\$1,400</u> 39 Ac.	—	—	—	—	—
39	39.64	3/4/55	4/5/55	\$ 16,500	\$416	\$ 20,000	\$505	—	—	<u>\$505</u> 39.64 Ac.	—	—	—	—	—
41	28.26	12/17/56	12/28/56	\$ 29,000	\$1,026	\$ 30,500	\$1,079	—	—	<u>\$1,300</u> 20.42 Ac.	—	<u>\$500*</u> 7.84 Ac.	—	—	—

\*Along Ventura River





## Appendix "A" (Cont.)

SUMMARY AND CLASSIFICATION OF ACREAGE SALES  
 Illustrative of the Testimony of  
 Laurence Sando, M.A.I. for Parcel CR-17 in Civil 974-57 PH filed 8/12/57

<u>Sale No.</u>	<u>Acres</u>	<u>Deed Dated</u>	<u>Deed Recorded</u>	<u>Sale Price</u>	<u>Aver. per Acre</u>	<u>Price adjusted to Aug. 1957</u>		<u>Rolling</u>	<u>Lower Slopes</u>	<u>Mountainous</u>
45	320.40	6/30/54	7/6/54	\$240,337	\$750	\$413,640	\$1,291 Ac.	<u>\$1,960</u> 150 Ac.	<u>\$1,050</u> 108 Ac.	<u>\$100</u> 62 Ac.
45A	230.40	5/27/56	5/27/56	\$194,750	\$845	\$224,640	\$975	<u>\$1,750</u> 60 Ac.	<u>\$1,050</u> 108 Ac.	<u>\$100</u> 62 Ac.
46	128.12	11/15/55	2/3/56	\$128,000	\$1,000	\$169,200	\$1,320	<u>\$2,000</u> 50 Ac.	<u>\$1,300</u> 50 Ac.	<u>\$150</u> 28.12 Ac.

SUMMARY AND CLASSIFICATION OF ACREAGE SALES  
 IN CONEJO VALLEY

Illustrative of the testimony of Laurence Sando, M.A.I. in the above action

51	693.35	3/15/55	4/1/55	\$275,000	\$400	\$376,000	\$543	<u>\$1,080</u> 280 Ac.	<u>\$450</u> 110 Ac.	<u>\$80</u> 303 Ac.
52	597.87	7/7/55	11/25/55	\$315,000	\$525	\$410,000	\$685	<u>\$1,200</u> 300 Ac.	<u>\$275</u> 150 Ac.	<u>\$60</u> 148 Ac.
53	284.49	6/9/55	6/30/55	\$202,500	\$713	\$263,150	\$925	<u>\$925</u> 284.49 Ac.	—	—
54	114.62	11/9/56	11/15/56	\$238,000	\$2,076	\$261,800	\$2,284	<u>\$2,284</u> 114.62 Ac.	—	—
55	252.00	4/25/57	5/21/57	\$520,000	\$2,064	\$535,500	\$2,125	<u>\$2,125</u> 252 Ac.	—	—
56	100.21	1/11/57	2/26/57	\$200,000	\$2,000	\$215,000	\$2,150	<u>\$2,150</u> 100.21 Ac.	—	—
57	266.07	11/1/54	11/23/54 Imps. Land	<u>\$157,500</u> 35,000 <u>\$122,500</u>	\$460	\$174,000	\$654	<u>\$1,500</u> 41 Ac.	<u>\$500</u> 225 Ac.	—
58	494.39	11/13/56	11/30/56	\$120,000	\$243	\$130,640	\$264	<u>\$1,200</u> 70 Ac.	—	<u>\$110</u> 424 Ac.





## APPENDIX "B."

### CHART NO. 1

Action No. 974-57 PH	Opinion of Value of Whole
Date of Value—	Parcel (1594.52 Ac.)
August 12, 1957	Before Take

By Jerry B. Carll, Sr.

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LAND: All as a part of the larger parcel before the taking.

Classification No. 1:	22-1	\$3176
214.82 Ac. East of Coyote Creek	23-5	3325
106.21 Ac. West of Coyote Creek	SB-1	3358
17.27 Ac. Deep Cat Lake	SB-2	2893

---

338.30 Acres of gentle sloping, rolling land, having a highest and best use of subdivision with riparian and/or appropriated water rights in Coyote Creek capable of constant year around supply sufficient to meet all the requirements of a residential subdivision of 321.03 acres; and included as a part of this classification the 17.27 acres of Deep Cat Lake.

Items #15,  
16 and part  
of Items #13

By reason of the ideal location in relation to the urban facilities of Ojai, Ventura, and Santa Barbara; the topography, climate, view, and clean environment; the seclusion from the general public, and highway traffic, these lands were available for subdivision, and could have been subdivided prior to the taking.

All public utilities needed were available.

338.30 Acres @ \$3,100 per acre \$1,048,730.00

CHART NO. 1—Continued

Classification No. 2:

154.26 Acres	Having a highest and best use for subdivision, but at a higher cost for development than the lands in Classification No. 1. These lands	19-7	\$1625
		19-8	2327
		19-10	1862
		22-2	2684
Part of	are sloping, undulating, and cut	SB-2	2893
Item #13	through with some small intermittent stream beds which would necessitate larger sites, and more costly roads. The sites would probably be of estate size. The development of a golf course on part of this classification of land would be very logical, in order to take advantage of the natural topography and beauty inherent and already available. The privacy available, by reason of location would make the lands of this classification admirably suited to a country club type of development. These lands have all of the attributes necessary for this type of development.		
	154.26 Acres @ \$1,850 per acre	\$	285,381.00

Classification No. 3:

38.52 Acres	Lands having a highest and best use for view type exclusive country estate. These lands are situate	23-7	\$3996
		SB-3	2057
		SB-4	3149
Item #1	atop the highest elevations east of Coyote Creek at the southeast corner of the property. They have a panoramic view, outstanding seclusion, and sufficient water for development to this use.		
	38.52 Acres @ \$2,000 per acre	\$	77,040.00

CHART NO. 1—Continued

Classification No. 4:

12.23 Acres	Having a highest and best use of	19-9	\$250
	protective fringe lands to the ex-	19-10	236
Part of Items	clusive country estate lands of	22-1	231
All of 2. plus	classification No. 3. These are	SB-2	258
9.08 ac.	sloping to steep lands between		
Of Item 11—	Coyote Creek and the country		
	estate lands.		
	12.23 Acres @ \$250 per acre	\$	3,057.00

Classification No. 5:

67.60 Acres	Creek bottom land having a high-	23-2	\$866
Items	est and best use of exclusive		
	recreation and park lands. These		
10— 5.69 ac.	lands would develop as a part of		
9—17.22 ac.	the subdivision and country club		
8—16.50 ac.	developments as an added amen-		
11—11.19 ac.	ity. The land has many beautiful		
3— 9.70 ac.	cabin sites, and could be sold		
4— 7.30 ac.	for such use, but it would be bet-		
	ter used as first mentioned. These		
	lands extend from Cola Dam		
67.60 ac.	down Coyote Creek to the south		
	property line, and also westward		
	up a wooded creek bottom west		
	of the headquarters. It is very		
	scenic and beautiful and could also		
	provide sites for picnic grounds.		
	67.60 Acres @ \$1,000 per acre	\$	67,600.00

Classification No. 6:

10.00 Acres	Having no foreseeable utility, be-	19-9	\$62
	ing rough and steep, but would be	19-10	59
Part of	protective land in the event of	22-2	66
Item #5	development of a dam at Dun-		
	shee Damsite.		
	10.00 Acres @ \$50.00 per acre	\$	500.00
		25-1	75

CHART NO. 1—Continued

Classification No. 7:

12.06 Acres	Headquarters area, having a high-	23-5	\$3325
	est and best use for development	23-7	3996
	headquarters. These lands are	SB-1	3358
	already developed to a high de-		
Part of	gree and by reason of the size and		
item #4	type of the main house, the guest		
	house, and other facilities that		
	could be used in developing all		
	the lands to their highest and best		
	uses, these lands would be very		
	valuable.		
	12.06 Acres @ \$4,000 per acre	\$	48,240.00

Classification No. 8:

107.59 Acres	Having a highest and best use	20-1	\$284
	for large rural rustic estates.	23-2	216
	These are mostly steep rough		
	lands with slight utility possibili-		
	ties, but the creek bottom land has		
	some recreational utility and there		
	are several view type building		
	sites on the ridges and benches		
	of Item #14 south of Coyote		
	Creek and north of Item #13.		
	107.59 Acres @ \$250 per acre	\$	26,897.00

Classification No. 9:

277.65 Acres	Having a highest and best use for	19-9	\$1032
	large acreage estates. These are	19-10	1862
	sloping hillside lands, brush cov-	23-6	1562
	ered, with several good springs.	24-1	1067
Items #5,	There are trees in the canyons	25-1	1000
17 & 8	and on the lower slopes. These		
	lands have many excellent build-		
	ing sites, and numerous small		
	bench lands. Orchards could be		
	planted on a large portion of		
	these lands. They afford very ex-		
	cellent views and are very desir-		
	able lands.		
	277.65 Acres @ \$900 per acre	\$	249,885.00



CHART NO. 1—Continued

Classification No. 10:

19-10	\$1862	10.33 Acres	Having a highest and best use for
19-11	1664		protective fringe and approach way
Item #6			to the western portion of classification No. 1—This is an alternate approach to the area west of Coyote Creek and would in all probability be used for the main access.
		10.33 Acres @ \$1,700 per acre	\$ 17,561.00

Classification No. 11:

136.53 Acres	Having a highest and best use of	19-6	\$1066
	large acreage estates. These lands,	10-10	1862
	while having the same name as	22-2	502
Part of	classification No. 9, are not considered as being as desirable or as having as many amenities. There are no known springs, and the water for development would have to be pumped from Deep Cat Lake. These lands are particularly suited, however, to the rural acreage estate type of development, particularly the northwest portion thereof. The land is sloping hillside, hilltop, and an intermitant creek borders it on the south. The land is penalized for the cost of roads and utilities.		
Item #21			
		136.53 Acres @ \$500 per acre	\$ 68,265.00

CHART NO. 1—Continued

Classification No. 12:

118.29 Acres	Having a highest and best use of large estates. These estates would be 10 to 40 acres and of the hideaway type. These lands are not of as high a caliber as those of classifications 9 and 11 and are more nearly like those in classification No. 8. These lands do have some building sites that are very good and by careful planning of roads for driveway purpose, these could be very appealing by reason of their amenities. The cost to pump water and bring in utilities as well as road cost puts a penalty against these lands.	Sale No.	Acre Adj. Price
		22-2	\$502
		SB-2	258
118.29 Acres @ \$350 per acre		\$	41,401.50

Classification No. 13:

311.16 Acres	Having a highest and best use of grazing land, being steep, rough, remote, and without practical access.	Sale No.	Adj. Price
		23-5	\$144
Item			
21— 31.16 ac.			
23—280.00 ac.			
<hr/> 311.16 ac.			
311.16 Acres @ \$100 per acre		\$	<u>31,116.00</u>
<hr/> 1594.52 Acres			
Total of Larger Parcel Contributed by Land			\$1,965,673.00

CHART NO. 1—Continued

Improvements

3600 sq.ft.	Main House	\$ 65,000
2000 sq.ft.	Guest House	20,000
	2 Unit Bungalow	7,500
	Bunk House	8,500
	Ranch Kitchen, Mess Hall & Apt.	5,000
	Milking Barn	8,000
	Milkers House	2,500
	Work Shop & Butchers Shop	5,500
	Horse Barn & Corral	10,000
	Hay Shed	2,000
	Hay Barn—next to Milk Barn	6,000
	Bull & Calf Pens	300
	Tool Shed	750
	Gas Station	250
	Grease Pit	100

Total Value Contributed to the

Whole by Improvements \$141,400

The Fair Market Value of 1594.52 Acres

Considered as a Whole and as Improved on August 12, 1957, and Before the Taking	\$2,107,073
Say	\$2,107,000

CHART NO. 2

Action No. 974-57 PH      Opinion of Value of Remainder  
V-R Ranch                      (768.46 ac) After Take

Date of Value:  
August 12, 1957

By Jerry B. Carll, Sr.

14.01 Acres	Originally having a highest and best use of subdivision classification No. 1, and in the after condition, having lost its water rights, and being subjected to limited access and the public using the project, has a highest and best use of dry farming.	23-2	\$1298
		24-1	533
	14.01 Acres @ \$350 per acre	\$	4,903.00
60.89 Acres	Originally classification No. 2, but	Sale	Adj.
(44.36)	in the after condition having a	No.	Price
(16.53)	highest and best use of dry farming.	23-2	\$1298
		24-1	533
	60.89 Acres @ \$350 per acre	\$	21,311.00
17.96 Acres	Originally classification No. 8, but in the after condition having a highest and best use of grazing land.	Sale	Adj.
		No.	Price
		24-1	\$80
		25-1	75
	17.96 Acres @ \$75 per acre	\$	1,347.00
109.62 Acres	Originally classification No. 9 on the slope of Laguna Ridge, but in the after condition has a highest and best use of grazing land.	Sale	Adj.
		No.	Price
		23-2	\$216
		23-5	144
		23-7	198
	109.62 Acres @ \$200 per acre	\$	21,924.00
254.82 Acres	Originally classifications No. 11 and No. 12, and called yonder acres, but in the after condition this is absolutely dry land, and has a highest and best use of dry grazing land.	Sale	Acres
		No.	Adj.
		22-2	\$66
		SB-2	77
	254.82 Acres @ \$100 per acre	\$	25,482.00
311.16 Acres	Originally classification No. 13, and in after condition has same	Sale	Adj.
( 31.16)	highest and best use.	No.	Price
(280.00)		19-9	\$62
		19-10	59
		24-1	53
	311.16 Acres @ \$50 per acre	\$	15,558.00
768.46 Acres	Remainder Valued @	\$	90,525.00

CHART NO. 3

---

PART TAKEN

324.29 Ac. of Classification No. 1		
324.29 Acres @ \$3100 per ac.		\$1,005,299.00
93.37 Ac. of Classification No. 2		
93.37 Acres @ \$1850 per ac.		\$ 172,179.50
38.52 Ac. of Classification No. 3		
38.52 Acres @ \$2000 per ac.		\$ 77,040.00
12.23 Ac. of Classification No. 4		
12.23 Acres @ \$250 per ac.		\$ 3,132.50
67.60 Ac. of Classification No. 5		
67.60 Acres @ \$1000 per ac.		\$ 67,600.00
10.00 Ac. of Classification No. 6		
10.00 Acres @ \$50 per ac.		\$ 500.00
12.06 Ac. of Classification No. 7		
12.06 Acres @ \$4000 per ac.		\$ 48,240.00
89.63 Ac. of Classification No. 8		
89.63 Acres @ \$250 per ac.		\$ 22,407.50
168.03 Ac. of Classification No. 9		
168.03 Acres @ \$900 per ac.		\$ 151,227.00
10.33 Ac. of Classification No. 10		
10.33 Acres @ \$1700 per ac.		\$ 17,561.00
<hr/>		
826.06 Acres		\$1,565,665.00
	Improvements	\$ 141,400.00
		<hr/>
Fair Market Value of Parcel CR-17 as of August 12, 1957		\$1,707,065.00





## APPENDIX "C."

### Answer to Appellant's Argument "C".

(Appellant's Br. pp. 11-17.)

In its Argument "C", the Government contends that the findings were inadequate for intelligent judicial review. This contention is the same as the Government's second objection urged before the District Court, *i.e.*:

"2. The findings of the commissioners on which they base their awards are insufficient as a matter of fact and inadequate as a matter of law."  
[R. 62.]

The only specification before the District Court of the alleged insufficiency as a matter of fact of the findings was the Government's contention that certain additional details, set forth in its proposed Supplemental Findings (see Appendix "B" this brief) should have been found by the commission. The Government made no specification of wherein the findings were "inadequate as a matter of law", though invited to do so. The Government itself filed no proposed findings of its own that would satisfy its own present demands. Attached hereto as Appendix "B" is the Government's Request for Findings of Fact, filed December 5, 1960, together with Supplementary Request for Findings of Fact, filed December 8, 1960. The Government filed no other proposed findings of fact or conclusions of law.

We cannot refrain from commenting upon the patently untrue statement in footnote 5 on page 17 of Appellant's Brief to the effect that:

"The fact is that the findings of the commission represented adoption *in toto*, except for the

amount awarded, of proposed findings submitted by the landowners. See affidavit and appendix, *infra*."

In the first place, no amount was contained in our proposed findings. Secondly, those proposed findings that were adopted were supported by evidence, as set forth in the citations to evidence in our proposed findings. And thirdly, most of the matters are now considered by Appellant to be undisputed matters (Appellant's Br. p. 17). And lastly, on the vitally important issue of highest and best use of the areas of the property [Findings 18 and 19, R. 43-48] the commission did not adopt our proposed findings "*in toto*"—far from it—we sincerely wish they had because then the verdict would probably have been between \$2,302,000.00 and \$2,016,000.00, rather than \$1,163,400.00.

The highest and best use of the property was one of the most important issues bearing on market value, the other being the water resources available. A cursory comparison between Findings 18 and 19 [R. 43-45] of the Commission and the findings proposed by Appellee (see proposed Findings 18 and 19—Appendix to Appellant's Br., pp. 45-50) shows that the commission did not adopt defendant's proposed findings *in toto*; not only did the commission drastically change the proposed findings, they found many uses entirely different from these proposed, for example:

(b) 154.26 ac.—proposed use, residential subdivision; use found, rural homesites.

(e)(2) 51.40 ac.—proposed use, exclusive recreation and park lands for development as part of a subdivision; use found, cabin sites.

(g) 12.06 ac.—proposed use, a dude ranch; use found, ranch home.

(k) 136.53 ac.—proposed use, large acreage estates; use found, rural homesite or cabinsite with limited agricultural possibilities.

(l) 118.29 ac.—proposed use, large estates ranging from 10-40 acres and of so-called hideaway type; use found, cabin sites.

Compare uses found [R. 43-45] with uses in proposed findings (Appellant's Br. Appendix pp. 45-50) and it can readily be seen that many additional suggested uses and refinements thereof were changed or eliminated by the commission. The statement in footnote 5, Appellant's Brief page 17, that findings of commission represented adoption *in toto*, except for amount awarded, of the proposed findings submitted by the landowners is just not true.

Examination of the findings contained in the "Benning" case report in case No. 17394 (the 1022 acre parcel adjoining the subject parcel on the south) shows that many of the facts regarding economy, history and growth of the area, climate, highway, rail, and air transportation, etc., are identical. It would be surprising if they were not, since they are in the same area and the same environmental factors ("undisputed matters." Appellant's Br. p. 17) affect both parcels and the findings are based on the same evidence, introduced on stipulation by reference. [See Deft. Ex. "Y", list of "Dunshee" exhibits introduced by stipulation]. Aside from those environmental facts which are identical to those found in the "Benning" case report, comparison of Finding 10 [R. 24-30] regarding

facts found regarding area, topography, terrain, vegetation, improvements, and classification of areas, with proposed Finding 10 (Appendix to Appellant's Br. pp. 30-35) shows that many matters were changed, and so much matter deleted from the proposed Finding 10 that it would be a monumental task to specify them all in this brief. Two things are clear, however. First, that the commission, though apparently using Appellee's proposed findings as the basis for their findings, carefully analyzed, altered, and eliminated the material as to show the findings were their carefully considered product, and, second, all the findings are supported by substantial evidence. Appellant has not pointed to any finding that is not so supported.



## APPENDIX "D".

### Response of Defendant V-R Ranch Co. to Plaintiff's Partial Memorandum in Support of Plaintiff's Objections to Commissioners' Report (Objec- tions 6, 7, 8, and 12).

United States District Court Southern District of  
California Central Division.

United States of America, Plaintiff, vs. 826.06 acres  
of land, more or less, in the county of Ventura, State of  
California, V-R Ranch Co., a corporation, et al., De-  
fendants. No. 974-57-PH Civil

Comes now defendant V-R Ranch Co., a corporation,  
and responds to plaintiff's written memorandum cover-  
ing plaintiff's original objections to the commissioners'  
report—being objections 6, 7, 8, and 12.

In its partial memorandum, the plaintiff covers only  
original objections 6, 7, 8, and 12, stating that plaintiff  
will file a supplementary memorandum covering objec-  
tions 15, 16, 18, and 31. Accordingly, defendant is  
confining this memorandum to the answers to plaintiff's  
written arguments regarding objections 6, 7, 8, and 12  
only. Defendant respectfully calls the court's attention  
to the statement of plaintiff that it does not waive any  
objection to said report previously argued before this  
court, but that: "It maintains that an examination by  
the court of the exhibits and transcript in the matter  
will verify the validity of these objections, and requests  
the court to make such an examination."

In the absence of any specific transcript reference,  
defendant *at this time* is unable to respond to these ob-  
jections and calls the court's attention to that portion  
of the Circuit Court's written opinion (page 13) in  
which it is stated:

“It is the function of the district court to review the commission’s report and findings in the light of objections made to it and to resolve the issues presented by such objections. It certainly need not, sua sponte, conduct its own search for error.”

Defendant will make written response to each of the original objections as soon as these objections have been supported by the Government by specific transcript reference. Meanwhile, defendant is confining its written response to the arguments presented in the partial memorandum covering objections 6, 7, 8, and 12.

The first dispute mentioned by the plaintiff is:

“Do the general findings of ‘regional’ transition from ‘agricultural to residential character’ set forth in the report have ‘any application or relevance to the lands in question’?”

The court’s attention is respectfully directed to that portion of the Circuit Court’s opinion (page 13) in which the court states:

“The highest and best use is not found from the past history or present use of these lands but from reasonable future probability *in the light of the history of the region in general* in its transition from agricultural to residential character.” (Italics added.)

*Answer to Objection 6:* The findings in the report covered by finding No. 5 relate to the economy, history, and growth of the *area*, including the immediate environs of the said property.

The Government makes no objection to the facts as found, but apparently only contends that the findings are immaterial and misleading and do not support the

awards of the commissioners in that there is “uncontraverted evidence in these proceedings that the greatest part by far of the economic, residential, and population growth of Ventura County \* \* \* occurred in the coastal cities of Ventura, Oxnard, and Port Hueneme and not in the immediate environs of the property”.

The facts that are set forth and to which objection 6 is directed (Report, page 4, line 18, to page 6, line 6) deal primarily with the general regional growth and are specifically covered by defendant’s Exhibit “AA” (Dunshree exhibit) in evidence by reference in defendant’s Exhibit Y (Tr. pages 68-71) in evidence by stipulation, and support the findings of highest and best use which are found “from reasonable future probability in the light of the history of the region in general in its transition from agricultural to residential character”.

It is also significant to note that the paragraph following the portion objected to by objection 6 makes specific findings with regard to the growth of the cities and communities in closest proximity to CR 17, being the cities of Ventura, Ojai, Oakview, and Meiners Oaks, and the report specifically finds (page 6, lines 7 to 22) the population of these cities and communities “sharing and participating in the growth of Ventura County”. These findings are not objected to by the Government.

With respect to the reference in plaintiff’s partial memorandum to plaintiff’s Exhibit 20a, which was introduced in evidence in cases Nos. 20,557 PH and 877-57 PH, but which was not introduced in evidence in the instant case. Reference to the transcript index listing plaintiff’s exhibits indicates that the only portion of Exhibit 20a introduced in evidence in the instant case

was introduced as plaintiff's Exhibit 2 in evidence herein (Tr. page 1540) entitled "Tabulation of Subdivision Lots Sold By Years, Ventura County".

In this respect, directing the court's attention to plaintiff's Exhibit 2 in evidence herein, the court's attention is also respectfully directed to the testimony of defendant's expert witnesses Mr. Carll (Tr. page 2073, line 20, to page 2077, line 1), and Mann (Tr. page 1538, line 18, to page 1566, line 2). An examination of this testimony reveals that the witnesses were definitely of the opinion that portions of the subject property were immediately available, both physically and economically, for development in residential subdivisions based upon their opinion of the reasonable future probability in light of the history of the region in general in its transition from agricultural to residential character.

*Answer to Objection 7:* Again plaintiff makes no objection that these facts found are not supported by the evidence, but contends that the factors which contribute to the rapid growth of the *county* are immaterial and misleading and do not support the awards of the commissioners in that there is no evidence in the proceeding that these factors were operative to any appreciable extent in the vicinity of the said property, to wit, the Santa Ana, Coyote Creek and Ojai Valleys.

In the first place, the court's attention is respectfully directed to the finding (page 6, lines 7 to 22) of the report, of the cities and communities in closest proximity to CR 17, and the specific finding to which the Government makes no objection—that these cities and communities were sharing and participating in the growth of Ventura County. The defendant's witnesses have testified that these factors were material and would be



considered by all well-informed purchasers in view of the reasonable future probability in light of the history of the region (Tr. page 1538, line 18 to page 1566, line 2—defendant's witness Mann—and Tr. page 2073, line 20, to page 2077, line 1—defendant's witness Carll). See also cross-examination of plaintiff's witness Mr. Evans (Tr. page 2448 to page 2465).

Defendant assumes that there is no objection to the evidence supporting the facts found in that portion of the report covered by objection 7 (page 6, line 26 to page 8, line 1), which the report specifically states applies to the County of Ventura, and the further fact that the facts set forth in the report (page 8, lines 2 to 25), which are not objected to, clearly show that the commission had in mind the varying degrees of growth and the varying effect on various portions of the county of the population growth, the economic and growth generally of the various areas in the county. In addition to the facts set forth in the report (page 8, lines 2 to 25) to which the Government has made no objection, the report further points out (page 8, lines 16 to 25) that: "In addition to the factors contributing to the growth of the County there were also factors limiting the growth of the CR 17 area." These factors include relatively small holdings of properties held in tight ownerships (see witness Carll, Tr. pages 1903, et seq.) to which the Government has made no objection.

It is therefore clear that the objection to materiality is not tenable since all of this evidence was introduced by stipulation and was testified to by all of the various witnesses. Nor can the facts covered by objection 7 be "misleading" in view of the fact that the report makes it very clear that in addition to factors contribut-



ing to the growth of the *County* there were also factors limiting the growth of the CR 17 area.

*Answer to Objection 8:* In objection 8, the Government contends that there was *no evidence* in the proceeding to support the findings set forth in finding No. 5, beginning at page 8, line 26, and ending at page 8, line 30, which finding reads:

“That with respect to the lands within the Santa Ana and Coyote Valleys and immediately surrounding areas, many of said properties were in the transition stage from dry farming and more intensive agriculture, to development for small rural estates and residential subdivisions.”

In response to this contention, the court’s attention is respectfully directed to Dunshee Exhibit “AA”—House Document 222 (in evidence by *stipulation* and by reference defendant’s Exhibit Y, Tr. p. 71). Attention is directed specifically to pages 27 through 30 and pages 76 through 77.

In addition to the facts set forth in said House Document 222, the commissioners viewed the entire area, including the subject property, on July 26 and 27 [Tr. pages 75 to 173]. The commissioners also viewed the entire area in connection with the so-called Dunshee cases, Nos. 20-577 PH and 877-57 PH, for a period of four full days, including an examination of all the sales, and it was stipulated by the parties that this view would also apply to and could be used in connection with the trial of CR 17. This view was in December of 1959.

*Answer to Objection 12:* Objection 12 is to a portion of the finding set forth in finding No. 6 be-

ginning at page 9, line 29, and ending on page 10, line 1, that “these buyers were, at the date of the taking, actually acquiring lands similar in type and character to the subject parcel, in other areas such as the Conejo and Thousand Oaks areas for the same or similar uses and purposes”. The objection recites that this finding is erroneous in that there is no evidence in the proceeding to support such finding. In answer to this contention, in the first place finding No. 6 is one complete sentence and objection 12 takes a single phrase out of context and objects only to it. Reading the entire finding in its context, it is unchallenged that (1) to the date of the taking there were buyers in the open market seeking to acquire lands of the character of said parcel for development and use (Findings, page 9, lines 27 to 29), and (2) that said buyers were acquiring similar and comparable properties for both immediate development and use and also for future development and use (Findings, page 10, lines 1 to 3), and also (3) finding no. 7 (page 10, lines 6 to 9) that buyers in these areas were acquiring lands for similar and comparable uses in areas having a climate, scenic beauty, water supply, and general environment less favorable than that of the subject property, which finding is not objected to by the Government.

It is in the context of these *unchallenged* findings that we must examine the phrase above objected to as erroneous as having no evidence to support it.

Time would not permit a detailed review of all of the sales in the Conejo and Thousand Oaks areas. The court’s attention is respectfully directed to the so-called 19 series showing eleven sales in the area of Conejo

and Thousand Oaks, all of which the commissioners examined in detail. These sales are described in detail as follows:

Defendant's expert witness George Mann—Tr. page 1273 to page 1341;

Defendant's expert witness Jerry Carll, Sr.—Tr. page 1781 to page 1840, line 11.

In its partial memorandum plaintiff makes passing reference to objection 31. Objection 31 states that there is no evidence in these proceedings, other than the bare opinion of defendant's witnesses to support Finding 20, page 31, line 32, to page 32, line 5, reading:

“The Commissioners find that Conejo Valley is and was a suitable area in which to find sales of property sufficiently alike to give some reasonable index of value for use in determining the fair market value \* \* \* .”

In response to this objection, the court's attention is respectfully directed to the fact that the commission on several occasions carefully examined the Conejo and Thousand Oaks area.

Both defendant and Government expert witnesses used Conejo Valley sales (George Mann—Tr. page 1309 to page 1341; Jerry Carll, Sr.—Tr. page 1809, line 23, to page 1840, line 11, and Tr. page 1781, line 19, to page 1797). Defendant's Exhibit V entitled “List of Comparable Sales in Evidence by Stipulation” (Tr. page 66) shows that there were eleven sales used by defendant's expert witnesses in the 19 series which cover the Conejo and Thousand Oaks area.

Furthermore, plaintiff's witnesses likewise utilized and discussed the Conejo Valley sales. The court's attention is directed to plaintiff's Exhibit 47 (Tr. page 3572) entitled "Summary—Classification 'Average' Sales—Sando", in which it will be observed that Mr. Sando lists eight sales, being Government sales Nos. 51 through 58, in that portion of Exhibit 47 entitled "Summary and Classification of Average Sales in Conejo Valley Illustrative of Testimony of Lawrence Sando, M.A.I."

Mr. Sando discusses the Conejo sales (Tr. page 3690, line 24, to page 3697, line 18), and compares Conejo Valley with Santa Ana Valley (Tr. page 3751, line 6, to page 3756, line 5). In stating his reasons for his opinion Lawrence Sando includes within his reasons "the prevailing prices in Conejo Valley", which, in his opinion, were about double that in Santa Ana-Coyote Valley (Tr. page 3772, lines 12 to 18).

Thus, it is clear that the Government's statement that there is no evidence other than the bare opinion of defendant's witnesses to support the finding that Conejo Valley "is and was a suitable area in which to find sales of property sufficiently alike to give some *reasonable index of value* \* \* \* " is clearly supported by the evidence. Not only did the defendant's witnesses state their opinions but they gave numerous reasons for their opinions, including a detailed analysis of the similarities in topography, climate, water supply, economic ripeness for subdivision, etc. (see particularly Tr. page 1538, line 18, to page 1566, line 2—Mann; and Tr. page 2073, line 20, to page 2077, line 1—Carll).



In view of the fact that the commission had before it a detailed description of all of the witnesses' various sales, and in further fact that they examined not only the subject property, but all of the sales in question, it is difficult to see how the Government can say there was no evidence to sustain the commission's finding 6 and the commission's finding 20.

In this connection, although not specifically covered by plaintiff's partial memorandum, defendant calls attention to plaintiff's objection 30 in which the Government objects to finding No. 20 (Report, page 31, lines 26 to 31) that:

"The Commissioners find that as of August 12, 1957, there were willing buyers in the open market for lands which were reasonably adaptable to all the uses which the evidence of both plaintiff and defendant showed that the lands in the subject property were reasonably adaptable and capable of being used as of said date."

This objection was made on the ground that such finding is misleading and immaterial, on the ground that plaintiff's witnesses did not testify that the portions of the whole property covered by findings Nos. 18(a) through 18(e), and findings Nos. 19(a) through 19(e) were, either physically or economically reasonably adapted to and capable of being used for the uses found by the commissioners in said findings to be the highest and best use for said portions of land as part of the whole property.

In the first place, the Government clearly misunderstands finding No. 20, which is that there were willing buyers in the open market for lands, which were evidenced by the sales, and which were reasonably adapt-



able to the uses testified to by both plaintiff and defendant. The plaintiff's witnesses testified that the highest and best use of the subject property was as a stock ranch or dude ranch or to divide into several smaller ranchos (Mr. Evans, Tr. pages 2159 to 2160), or for possible golf course use (Tr. page 2162, line 16), or physically capable of being cut into one to one and one-half acre lots of which you could sell quite a few (Tr. page 2162, line 25), or subdivided into smaller estates, a dairy ranch, or what have you (Tr. page 2407, line 20, to page 2408, line 7). See also Mr. Evans' highest and best use as a stock ranch or a group of ranchos or a group of country places (Tr. page 2737, line 19), and Mr. Sando's highest and best use as a "cattle ranch in the main sense and more specifically I recognize that there is a potential subdivision for a small part of it" (Tr. page 3545, lines 7 to 22), or for use as a dude ranch (Tr. page 3546, line 1, and Tr. page 3778, line 3, et seq.).

Thus, all of the witnesses, including the plaintiff's witnesses, testified to a variety of highest and best uses for various portions of the subject property, and the commission finds in finding No. 20, in view of all of the sales which they examined and which were described to them in detail, that there were willing buyers in the open market for lands that were reasonably adaptable to all the uses which the evidence of both plaintiff and defendant showed that the lands in the subject property were reasonably adaptable and capable of being used. It is respectfully submitted that the evidence sustains this finding.

Defendant V-R Ranch Co. has been advised that the Government intends to file a supplementary memoran-

dum covering objections 15, 16, 18, and 31 not included in the partial memorandum to which this memorandum is in response. Defendant V-R Ranch Co. respectfully reserves the right to respond in writing to this supplementary memorandum if and when it is filed.

Respectfully submitted,

ANSON, GLEAVES & LARSON,  
By JOHN B. ANSON,

*Attorneys for Defendant V-R Ranch Co.*

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EVELYN DI FIORE

er 611 Sunset Boulevard, Los Angeles 12, California.

September 21 62 RESPONSE OF DEFENDANT  
V-R RANCH CO. TO PLAINTIFF'S PARTIAL  
MEMORANDUM IN SUPPORT OF PLAINTIFF'S  
OBJECTIONS TO COMMISSIONERS REPORT  
(Objections 6, 7, 8 and 12).

plaintiff

Sunset and Grand  
s plaintiff  
Mr. Francis C. Whelan,  
United States Attorney.

s Mr. John B. Read,  
Assistant U.S. Attorney,  
821 Federal Building,  
Los Angeles 12, California.

Evelyn Di Fiore

September 21 62

JOHN B. ANSON,  
My Commission Expires  
July 12, 1963

## APPENDIX "E."

### Transcript Pages Dealing With Water Testimony Only.

RALPH B. NUNNELLEY (V-R Ranch Co. expert witness):

Direct examination	Tr. 379-842	463 pages
Cross-examination	Tr. 842-1210	368 pages
Re-Direct examination	Tr. 1216-1221	11 pages
Re-Cross examination	Tr. 1221-1229	8 pages
Rebuttal (labeled direct examination in index)	Tr. 3932-4198	266 pages
Cross-examination on Rebuttal	Tr. 4198-4323	125 pages
	Tr. 4329-4555	226 pages

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Ralph B. Nunnelley on "water resources" alone: 1,467 pages

MAX BOOKMAN (Government water expert witness):

Direct examination	Tr. 2529-2866	337 pages
Cross-examination	Tr. 2866-3424	558 pages
Re-Direct examination	Tr. 3424-3491	67 pages

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Max Bookman total "water" testimony: 962 pages



## APPENDIX "F."

<u>EXHIBIT</u>		Transcript Pages	
		<u>Mkd.</u>	<u>Rcd.</u>
Plaintiff's :			
11	Precipitation Record Dept. Public Works California—Selby	2534	2534
12	Precipitation Record Dept. Public Works California—Mallory	2534	2534
13	Chart—Bookman—Monthly Discharge Ventura River	2536	2536
14	Chart—Bookman—Monthly Discharge Coyote near Ventura	2537	2537
15	Chart—Bookman—Discharge—Annual Matilija Creek at Matilija	2539	2539
16	Chart—Bookman—Discharge—Annual Matilija	2536	2536
17	Casitas Dam—Logs of Exploration for Borrow Area	2540	2540
18	Casitas Dam—Location of Explorations for Borrow Areas A and B	2540	2540
19	Casitas Dam—Log of Test Pit or Auger Holes	2541	2541
20	Gradation Test Ventura River Preconstruction Investigation	2542	2542
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## APPENDIX "G".

Examination of defendant's exhibits "2W," "3D," and "3F" will show that they are extremely detailed charts setting forth witnesses' opinions in the following matters:

(1) The value of the whole parcel (1,594.52 acres) of which the portion taken (826.06 acres) was a part, as a single unit in light of its highest and best use. These figures were as follows:

Ralph B. Nunnelley	\$2,574,000.00	(Chart 1— Deft. Ex. "2W")
George S. Mann	\$2,168,862.00	(Chart 1— Deft. Ex. "3D")
Jerry B. Carll, Sr.	\$2,107,000.00	(Chart 1— Deft. Ex. "3F")
Bernard G. Evans	\$ 660,000.00	(Pltf. Ex. 8)
Lawrence Sando	\$ 671,000.00	(Pltf. Ex. 51)
Commissioners' Report	\$1,330,000.00	(R. 52)

The foregoing charts contained a complete breakdown of the land classifications of the various type of land in the entire parcel of property keyed in its numbering system to defendant's Exhibit "M2"—the land classification map—and containing the number of acres and description of each classification and the witnesses' opinions of value.

(2) Value of the remainder after the taking, i.e., the value immediately following the taking of the remainder not taken (768.46 acres) in light of its then highest and best use. These figures were as follows:

Ralph B. Nunnelley	\$ 252,000.00	(Chart 2 of Deft. Ex. "2W")
George S. Mann	\$ 145,094.00	(Chart 2 of Deft. Ex. "3D")
Jerry B. Carll, Sr.	\$ 90,525.00	(Chart 2 of Deft. Ex. "3F")
Bernard G. Evans	\$ 71,750.00	(Pltf. Ex. 8)
Lawrence Sando	\$ 73,000.00	(Pltf. Ex. 51)
Commissioners' Report	\$ 166,600.00	(R. 52)

(3) Difference between the value of the whole before the taking and the value of the remainder after the take, representing the total damages. These figures are as set forth in the preceding paragraph under just compensation.

(4) That portion of the total damages consisting of the value on August 12, 1957, of the 826.06 acres taken (including improvements). These figures are as follows:

Ralph B. Nunnelley	\$1,919,000.00	(Chart 3 of Deft. Ex. "2W")
George S. Mann	\$1,754,000.00	(Chart 3 of Deft. Ex. "3D")
Jerry B. Carll, Sr.	\$1,707,065.00	(Chart 3 of Deft. Ex. "3F")
Bernard G. Evans	\$ 563,900.00	(Pltf. Ex. 8)
Lawrence Sando	\$ 587,000.00	(Pltf. Ex. 51)
Commissioners' Report	\$1,104,900.00	(R. 52)

(5) That portion of total damages constituting diminution in market value of the part not taken (severance damages). These figures are as follows:

Ralph B. Nunnelley	\$ 403,000.00 (Summary of 3 charts —Deft. Ex. “2W”)
George S. Mann	\$ 269,500.00 (Summary of 3 charts —Deft. Ex. “3D”)
Jerry B. Carll, Sr.	\$ 309,410.00 (Summary of 3 charts —Deft. Ex. “3F”)
Bernard G. Evans	\$ 24,350.00 (Pltf. Ex. 8)
Lawrence Sando	\$ 11,000.00 (Pltf. Ex. 51)
Commissioners’ Report	\$ 58,500.00 (R. 52)

In addition to the foregoing figures, these charts, defendant’s Exhibits “2W,” “3D,” and “3F,” admitted by stipulation of counsel, contained a detailed description of the witnesses’ land classification, their reasoning, and in the case of the expert appraisal witnesses George S. Mann (Defendant’s Exhibit “3D”) and Jerry B. Carll, Sr., (Defendant’s Exhibit “3F”), these charts contained a list by sales number of the comparable sales of assistance to these witnesses for their various opinions, together with the adjusted prices per acre of the comparable sales. For example, see Chart 1 of Defendant’s Exhibit “3F” in evidence.

The opinions of value and the land classification of the Government’s expert appraisers were set forth in similar detail in written exhibits. (See Bernard G. Evans—Plaintiff’s Exhibit 5, Summary of Evans’ testimony as to land classification; Plaintiff’s Exhibit 8,

Summary of Evans' Value Testimony; Plaintiff's Exhibit 9, Evans' Comparable Sales Pattern Chart; Lawrence Sando—Plaintiff's Exhibit 47, Sando Sales Data; Plaintiff's Exhibit 48, Sando Land Classification Map; Plaintiff's Exhibit 51, Sando Value Chart.)

Thus, the value opinions, the land classification, the reasoning and the sales used by all of the valuation witnesses were set forth in complete detail, were before the District Court, were argued by counsel, and were considered by the court.

In addition to the foregoing written exhibits, the qualifications of all of the expert witnesses, including the water engineers for both sides, were set forth in full in writing and were made exhibits in the case under stipulation of counsel that they would have the same force and effect as though the witness had testified orally into the record. For defendant's qualifications, see defendant's Exhibit "U" in evidence which sets forth in detail the general qualifications, educational background and experience, together with the special qualifications, i.e., what was done to prepare the opinions of the expert witnesses of the following:

George Lindebergh, architect, whose detailed analysis and description of the ranch improvement is set forth in defendant's Exhibit "S," Ralph B. Nunnelley, engineer and president of V-R Ranch Co.; George S. Mann and Jerry B. Carll, Sr., expert appraisal witnesses.

In similar fashion, the general and special qualifications of the Government's expert witnesses were set forth in written exhibits as follows:

Bernard G. Evans, Plaintiff's Exhibit 4; Max Bookman, Plaintiff's Exhibit 10; Lawrence Sando, Plaintiff's Exhibits 45 and 46.

In addition, all of the expert testimony, the studies made by the experts, and their conclusions regarding the water resources were all set forth in written exhibits.





No. 18633

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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MARGARET DAVIS, *et al.*,

*Appellants,*

*vs.*

PAULINE D. McLAUGHLIN, Administratrix of the  
Estate of Ingram M. Stainback, deceased,

*Appellee.*

---

## BRIEF OF APPELLEE.

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MITCHELL, SILBERBERG & KNUPP and  
HOWARD S. SMITH,  
FONG, MIHO, CHOY & ROBINSON and  
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**FILED**

DEC 13 1963

W. H. SCHAND, CLERK



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No. 18633

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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MARGARET DAVIS, *et al.*,

*Appellants,*

*vs.*

PAULINE D. McLAUGHLIN, Administratrix of the  
Estate of Ingram M. Stainback, deceased,

*Appellee.*

---

## BRIEF OF APPELLEE.

---

### Statement of Jurisdiction.

This action was commenced in the United States District Court for the District of Hawaii by appellants as plaintiffs against J. Frank McLaughlin, administrator of the estate of Ingram M. Stainback, deceased. Jurisdiction was based on diversity of citizenship and amount in controversy. 28 U. S. C. §1332. [See Paragraph 1 of the Complaint, Tr. p. 3.] Subsequent to the commencement of this action, Pauline D. McLaughlin, administratrix *de bonis non* of the estate of Ingram M. Stainback, deceased, was substituted as defendant in place of the late Judge McLaughlin. [Tr. pp. 32-33.]

The district court dismissed this action with prejudice. [Tr. pp. 12-13.] An appeal was taken to this court pursuant to rule 73 of the Federal Rules of Civil

Procedure and 28 U. S. C. §§ 1291 and 2107. Appellee moved to dismiss the appeal on the ground that this court has no jurisdiction of the appeal; this motion was denied by written order dated July 8, 1963.

### **Statement of the Case and of the Proceedings Below.**

Appellants' brief contains no statement of the case. As we think such a statement will assist the court in determining this appeal, a summary of the material proceedings below follows. Throughout the remainder of this brief, plaintiffs and appellants will be designated "appellants" and defendant and appellee and her predecessor defendant-administrator will be designated "appellee."

Appellee's intestate, Ingram M. Stainback, was for many years Governor of the Territory of Hawaii.

This action was filed by appellants on December 8, 1961. The gist of appellants' asserted claim, as disclosed by the complaint and Exhibit A thereto (a copy of a Statement of Claim of Creditors made by appellants to, and rejected by, Governor Stainback's administrator) is [Tr. pp. 2-10]:

After the death of Governor Stainback's wife, Cecile White Stainback, on October 11, 1949, Governor Stainback destroyed her will, in which she had bequeathed all her property to her parents, and concealed property belonging to her from the administrator of her estate. On February 19, 1952 the net estate of Mrs. Stainback was distributed one-half to appellants<sup>1</sup> and one-half to Governor

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<sup>1</sup>The estate was distributed one-half to Governor Stainback and one-fourth each to the estates of the mother and father of appellants. Appellants allege that the net estates of their parents were

ultimately distributed to them. [Tr. p. 7.]

Stainback. Governor Stainback died intestate on April 12, 1961.

On January 16, 1962 a notice to take the deposition of appellant Georgia McPheeters was filed. [See Tr. p. 49.] After some difficulty, appellant McPheeters' deposition was taken in Honolulu on Saturday, January 27 and Sunday, January 28, 1962. [See Tr. pp. 73-77 and 110-113.]

On January 31, 1962 appellants filed and served written interrogatories to appellee. Appellee filed answers to these interrogatories on February 26, 1962, and an amended answer on March 9, 1962. [See Tr. p. 49.]

On June 15, 1962, appellee filed a motion to dismiss or for a more definite statement. [Tr. pp. 53-56.]

On July 2, 1962, the deposition of appellant Georgia McPheeters was filed in the district court. [See Tr. p. 49.]

On July 6, 1962, before any hearing on appellee's motion to dismiss or for a more definite statement, appellants' attorney, E. D. Crumpacker, Esq., filed a motion for leave to withdraw as counsel for appellants. [Tr. pp. 57-58.] On July 12, 1962 there was a lengthy hearing on Mr. Crumpacker's motion in which appellant McPheeters personally participated. [Tr. pp. 141-174.] Appellee opposed Mr. Crumpacker's request for leave to withdraw as counsel for appellants. [Tr. p. 162.] After hearing both Mrs. McPheeters and Mr. Crumpacker, the court conditionally granted Mr. Crumpacker's motion for leave to withdraw but ordered him to notify each appellant other than appellant McPheeters that he had moved to withdraw as their attorney, that



there would be a further hearing on his motion to withdraw, and that unless appellants appeared and showed cause why he should not be permitted to withdraw, he would be so permitted. [Tr. pp. 167-170.] The court further ordered Mr. Crumpacker to send a copy of appellee's motion to dismiss to each appellant with notice that the motion would be heard at 9:00 A.M. on September 4, 1962. [Tr. pp. 170-174. See Tr. pp. 49 and 136.] On July 20, 1962 the court granted Mr. Crumpacker leave to withdraw [Tr. p. 136], and a written order to that effect was filed on July 26, 1962. [Tr. pp. 59-60.]

On August 30, 1962 appellants' present counsel, Brahan Houston, Esq, filed his appearance [Tr. pp. 24-25] and a notice of dismissal—purportedly without prejudice under Rule 41(a)(1) of the Federal Rules of Civil Procedure. [Tr. pp. 61-62.]

The same day—August 30, 1962—that appellants purported to dismiss this action in the district court they commenced in the Circuit Court of the First Circuit of the State of Hawaii a new suit based on the same claim asserted in this action. The defendants in the state court action were Judge McLaughlin as administrator of the estate of Governor Stainback and the Cooke Trust Company, Ltd., which had been administrator of Mrs. Stainback's estate.<sup>2</sup>

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<sup>2</sup>On December 19, 1962 the district court granted leave to appellants and appellee to file copies of the various papers which had been filed in the state court action. [Tr. p. 50.] These documents were filed with the clerk of the district court, although the transcript on appeal does not so indicate. The various documents filed in the state court, consisting of a summons and complaint, notice of dismissal, motion and affidavit to amend notice of dismissal, and notice of hearing and order denying motion to amend notice of dismissal, were designated by appellee

On September 7, 1962 appellee moved to strike the notice of dismissal filed by appellants or in the alternative that the court permit dismissal by appellants only on just and reasonable terms and conditions. [Tr. pp. 63-64.] On September 17, 1962 the district court “ruled that the notice of dismissal stand, conditioned upon the payment to defendant of his costs, etc., and if an agreement on the amount cannot be reached, then hearing on the matter be set for November 1, 1962 at 9 a.m.” [Tr. p. 136. See also Tr. p. 49.] A written order to this effect which also provided that counsel for the respective parties should confer in an attempt to agree on the amount appellants should pay appellee was filed on October 1, 1962. [Tr. pp. 65-66.]

Appellee filed memoranda of costs and attorneys’ fees and affidavits with respect thereto on November 1 and November 8, 1962. [Tr. pp. 67-69; 70-78.]

On November 8, 1962, at a continued hearing on the amount of costs and attorneys’ fees to be assessed, the district judge made it clear that in his opinion the only basis for a dismissal was under Rule 41(a)(2) of the Federal Rules of Civil Procedure, and that unless otherwise specified in the order of dismissal, such a dismissal would be *without prejudice*. [Tr. p. 176.] The court set the amount of \$4,967.25 as the amount to be paid by appellants to appellee as the condition of a voluntary dismissal without prejudice. [Tr. pp. 177-178.] On November 29, 1962 a written supplemental order on appellee’s motion to strike appellants’ notice of dis-

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to constitute a part of the record on appeal in this action. [Tr. pp. 133-135.] We have been informed that they have been transmitted by the clerk of the district court to the clerk of this court.

missal was filed [Tr. pp. 94-95]; this order was amended in open court on December 19, 1962 [Tr. pp. 50-51, 138 and 202.] This supplemental order as so amended provides:

“IT IS HEREBY ORDERED that the Plaintiffs jointly and severally pay to the Defendant or his legal successor within thirty (30) days from the entry hereof, the sum of FOUR THOUSAND NINE HUNDRED SIXTY SEVEN AND 25/100 DOLLARS (\$4,967.25) for the costs and attorneys’ fee incurred by Defendant in this matter; and in the event the Plaintiffs shall fail to meet this condition, this cause will stand dismissed with prejudice for failure to comply with terms and conditions of court.”

On November 19, 1962, eleven days after the court had ruled that appellants’ dismissal of this action without prejudice was to stand on condition that they pay appellee’s costs and expenses in the amount of \$4,967.25, appellants filed: (1) a motion to amend the complaint; (2) a document entitled “Plaintiffs’ Election to Continue On In This Court and Cause”; and (3) a motion for Judge Pence to recuse himself “because of bias and prejudice on the part of the Honorable Martin Pence toward plaintiffs and their cause” together with an affidavit of appellants’ attorney in support thereof. [Tr. pp. 79-87.]

The next day, November 20, 1962, appellants filed a document entitled “Plaintiffs’ Joinder in Defendant’s Motion to Strike Plaintiffs’ Dismissal”. [Tr. pp. 88-89.]

An affidavit of prejudice by appellant Georgia McPheeters was filed on November 29, 1962. [Tr. pp.

90-93.] The same day the motion for Judge Pence to recuse himself was denied. [Tr. pp. 50 and 138.]

On December 5, 1962 a written order denying appellant's motion for Judge Pence to recuse himself was signed and filed. [Tr. pp. 97-98.]

Appellants then filed motions to set aside the district court's orders. [Tr. pp. 99-101; 106-108.] On December 19, 1962 these motions were denied and, after an extensive colloquy between the court and counsel for appellants, the order dated November 29, 1962 was amended. [Tr. pp. 50, 138 and 182-204.]

On January 9, 1963 this action was ordered dismissed with prejudice for failure of appellants to fulfill the terms and conditions fixed by the court within the prescribed time. [Tr. pp. 12-15.]

### Questions Presented.

There are but two questions presented by this appeal:

1. Did the district judge err in refusing to recuse himself?
2. Did the district court err in dismissing this action with prejudice upon the failure of appellants to meet the terms and conditions imposed by the court?

Appellee contends that the district court did not err either in denying appellants' motion that the district judge recuse himself or in dismissing this action with prejudice.



## ARGUMENT.

### I.

#### The District Judge Did Not Err in Refusing to Recuse Himself.

Appellants strongly charge the district judge with error and worse sins in his denial of their motion that he recuse himself. The facts and applicable law clearly establish, however, that the district judge committed no impropriety whatsoever in refusing to recuse himself. The following discussion is perhaps more extensive than it need be. We present it, however, because of the virulence and persistence of appellants' personal attack on Judge Pence. We wish to show that Judge Pence's refusal to disqualify himself was correct and in accordance with his obligations under well-settled law.

The motion for Judge Pence to recuse himself states that it is made "because of bias and prejudice on the part of the Honorable Martin Pence towards Plaintiffs and their cause" and "is based on the record and the memorandum in support of the Motion attached hereto." [Tr. p. 84.] The affidavit of Mr. Houston attached to the motion complains against Judge Pence solely because of an alleged statement to Mr. Houston by one of appellee's attorneys to the effect that Judge Pence, on being informed that counsel had not conferred as ordered by him, stated "that if counsel for plaintiffs did not get together with counsel for defendant, he would be sorry." [Tr. p. 86.]



The affidavit of prejudice of appellant Georgia McPheeters alleges that Judge Pence is biased against appellants because:

(1) At the hearing before Judge Pence on the motion of appellants' former attorney, Mr. Crumpacker, for leave to withdraw as appellants' attorney, Mr. Crumpacker allegedly charged appellants with bad faith and "disparaged" them. Judge Pence expressed confidence in Mr. Crumpacker's integrity and granted him permission to withdraw as appellants' attorney.

(2) "[I]t is impossible for Judge Pence to disabuse his mind of the impression created by Mr. Crumpacker's said disparagement of plaintiffs and their cause of action" and Judge Pence "in his remarks from the bench on November 8, 1962" had shown "conclusively that Judge Pence holds Mr. Crumpacker's remarks against plaintiffs and is influenced by them at this late day."

(3) The same alleged statement attributed to one of appellee's attorneys by Mr. Houston in his affidavit in support of the motion for Judge Pence to recuse himself.

(4) That Judge Pence imposed the payment by appellants of "nearly \$5,000.00" to appellee as a condition of the voluntary dismissal without prejudice of this action.

(5) That Judge Pence allegedly made a certain ruling in this action: "that plaintiff relied on this wholly arbitrary action of Judge Pence in their Motion to Disqualify Judge Pence, filed November 16, 1962, that Judge Pence thereafter or thereupon changed his ruling, but that the

fact that he made such a ruling shows his prejudice against plaintiffs.” (Emphasis supplied.) [Tr. pp. 91-93.]

In their brief on appeal appellants rely only on one *fact* to support their contention that Judge Pence erred in refusing to disqualify himself—that Judge Pence presided at the hearing on the motion of Mr. Crumpacker, appellants’ former attorney, for leave to withdraw as appellants’ attorney. Appellants allege that at that hearing Mr. Crumpacker “publicly crucified” his clients, made statements “to impeach his clients and discredit their case” (Brief of Appellants, p. 6), and “denigrated plaintiffs’ case” (App. Br. p. 7). Having thus characterized the statements of Mr. Crumpacker, appellants next make sinister inference from statements of Judge Pence that he knew Mr. Crumpacker’s reputation and background and that he believed that Mr. Crumpacker had acted with honesty, sincerity, integrity and candor. [App. Br. pp. 2, 3 and 9. See Tr. pp. 155-156 and 157.] From these characterizations and inferences appellants conclude:

“[I]t would seem to be humanly impossible for . . . [Judge Pence] to disabuse [his] . . . mind of the effect of the abovementioned representations made by the said attorney or to escape the conclusion or the suspicion that plaintiffs’ suit is vexatious. So it seems to plaintiffs and they believe they have taken a common sense view of the matter.” (App. Br. pp. 3-4.)

And:

“It was obvious that Appellants would encounter a disadvantage in trying their case before Judge Pence which they would not encounter in a

trial before Judge Tavares. It would seem that the slightest sensitivity to judicial impropriety would have moved Judge Pence to let Judge Tavares try the case.” (App. Br. p. 9.)

Appellants have apparently forgotten the care Judge Pence took to protect their rights. In addressing Mrs. McPheeters, he pointed out that he did not “know enough about the facts and cannot know enough about the facts until the case is tried to say whether or not what was done at that time affects your own particular claim.” [Tr. p. 161.] He directed that all appellants receive formal written notice that Mr. Crumpacker’s motion to withdraw would be heard so that they might have an opportunity to appear and be heard, either personally or by counsel; he carefully and in detail advised Mrs. McPheeters that at the next hearing on Mr. Crumpacker’s motion, Mr. Crumpacker would be permitted to withdraw if appellants made no further showing, but that “If you [Mrs. McPheeters] or any of the rest of them [appellants] at that time wish to have the matter heard, I will formally consider anything which you or any of the rest of them wish to offer. . . .” [Tr. p. 169; see Tr. pp. 167-170.] He expressly advised Mrs. McPheeters that she and the other appellants could, if they wished, be represented by other counsel to oppose Mr. Crumpacker’s withdrawal. [Tr. pp. 167-168.] He invited appellants to present something to him “which completely throws out the representation of counsel here”. [Tr. p. 168.] He further required Mr. Crumpacker to send to each appellant a copy of appellee’s motion to dismiss and to inform each appellant of the date on which that motion would be heard in order to give each appellant oppor-

tunity to consult with an attorney about that motion. [Tr. pp. 170-174.]

Appellants' contention that Judge Pence should have recused himself is based on two allegations: (1) at the hearing at which appellants' former attorney sought leave to withdraw as appellants' counsel, Judge Pence heard certain derogatory remarks about appellant's case made by their counsel which caused him to make up his mind that appellants' case had no merit; and (2) Judge Pence made certain rulings in this action adverse to appellants. As a matter of law neither of these allegations is sufficient to require Judge Pence to rescue himself.

The correctness of the denial of appellants' motion for Judge Pence to recuse himself is governed by 28 U. S. C. §144 which provides:

“Whenever a party to any proceeding in a district court makes and files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to hear such proceeding.

“The affidavit shall state the facts and the reasons for the belief that bias or prejudice exists, and shall be filed not less than ten days before the beginning of the term at which the proceeding is to be heard, or good cause shall be shown for failure to file it within such time. A party may file only one such affidavit in any case. It shall be accompanied by a certificate of counsel of record stating that it is made in good faith.”



In apparently the first case construing §21 of the Judicial Code of 1911, the predecessor of 28 U. S. C. §144, *Ex parte American Steel Barrel Co.*, 230 U. S. 35 (1913), the Court stated:

“The basis of the disqualification is that ‘personal bias or prejudice’ exists, by reason of which the judge is unable to impartially exercise his functions in the particular case. *It is a provision obviously not applicable save in those rare instances in which the affiant is able to state facts which tend to show not merely adverse rulings already made, which may be right or wrong, but facts and reasons which tend to show personal bias or prejudice.* It was never intended to enable a discontented litigant to oust a judge because of adverse rulings made, for such rulings are reviewable otherwise, but to prevent his future action in the pending cause. Neither was it intended to paralyze the action of a judge who has heard the case, or a question in it, by the interposition of a motion to disqualify him between a hearing and a determination of the matter heard. This is the plain meaning of the requirement that the affidavit shall be filed not less than ten days before the beginning of the term.” 230 U. S. at 43-44. (Emphasis supplied.)

Section 21 of the Judicial Code of 1911 was again construed in *Berger v. United States*, 255 U. S. 22 (1921), in which the Court held sufficient to disqualify a district judge an affidavit of prejudice charging that the judge (Judge Kenesaw Mountain Landis) had a “personal bias and prejudice” against defendants, persons of German extraction, because of certain remarks



he had made before the trial derogatory to German-Americans. The Court specifically held in the *Berger* case that a district judge has “a lawful right to pass upon the sufficiency of an affidavit of prejudice filed against him.” *Id.* at pages 30 and 36. The Court further held:

“The case [*Ex parte American Steel Barrel Co.*, *supra*, 230 U.S. 35] establishes that the bias or prejudice which can be urged against a judge *must be based upon something other than rulings in the case.*” *Id.* at p. 31. (Emphasis supplied.)

“Of course, the reasons and facts for the belief the litigant entertains [that the judge is personally biased against him] are an essential part of the affidavit, and must give fair support to the charge of a bent of mind that may prevent or impede impartiality of judgment.” *Id.* at pp. 33-34.

“The section [Section 21 of the Judicial Code] permits only the affidavit of a party, and *Ex parte American Steel Barrel Co.*, *supra*, decides that *it must be based upon facts antedating the trial, not those occurring during the trial.*” *Id.* at p. 34. (Emphasis supplied.)

These two decisions of the Supreme Court show that Judge Pence did not commit error in denying appellants' motion that he recuse himself. He had the right to determine the legal sufficiency of the motion and affidavit of prejudice. The motion and affidavit were based solely on rulings made by him in the course of this action and on statements made (or alleged made) to or by him during proceedings in this action.

The decisions of this court emphasize the correctness of the ruling of Judge Pence refusing to

disqualify himself. In *Price v. Johnston*, 125 F. 2d 806 (9th Cir.), cert. denied, 316 U. S. 677 (1942), this court held insufficient as a matter of law an affidavit of prejudice alleging that the trial judge was prejudiced against the defendant in a criminal prosecution because the judge was a director or associated with a bank in the vicinity of the bank for the robbery of which the defendant was indicted. In so ruling, this court held:

“[T]he trial judge did have the lawful right to pass upon the legal sufficiency of the affidavit.” 125 F. 2d at p. 811.

“The statute requires that the bias or prejudice be personal’. . . . The plain purpose of the statute ‘was to afford a method of relief through which a party to a suit may avoid trial before a judge having a personal bias or prejudice against him or in favor of the opposite party. That sought to be relieved against is a personal bias or prejudice—a bias or prejudice possessed by the judge specifically applicable to or directed against suitor making the affidavit or in favor of his opponent.’” Appellant’s allegations reveal that ‘the facts and reasons advanced in support of the charge of bias and prejudice *do not tend to show the existence of a personal bias or prejudice on the part of the judge toward petitioner but rather a prejudgment of the merits of the controversy \* \* \**’ . . . It is immaterial that the trial judge may have assigned an incorrect reason for his ruling on the affidavit; the ruling was correct, and that is sufficient.” *Id.* at pages 811-812, citations of authority omitted. (Emphasis supplied.)

Statements in an affidavit of prejudice that the judge has already made up his mind to decide against the affiant and that he therefore has a personal bias or prejudice against the affiant “are not statements of fact but are conclusions of the affiant” and therefore insufficient to require the district judge to disqualify himself even in a criminal case. *Willenbring v. United States*, 306 F. 2d 944 (9th Cir. 1962). Indeed, this court has characterized such allegations as “flagrant contempt of court.” *Barnes v. United States*, 241 F. 2d 252, 254 (9th Cir. 1956).

This court has also held:

“[S]uccessive rulings of the judge adverse to . . . [a party] and his comments on . . . [that party’s] method of conducting his case . . . [do not] constitute personal prejudice against [that party]. . . .” *Beecher v. Federal Land Bank*, 153 F. 2d 987, 988 (9th Cir.), cert. denied, 328 U. S. 871 (1946).

In *Cole v. Locw’s, Inc.*, 76 F. Supp. 872 (S.D. Cal. 1948), affirmed on this ground and reversed on other grounds, 185 F. 2d 641 (9th Cir. 1950), cert. denied, 340 U. S. 954 (1951), Judge Yankwich, in refusing to recuse himself, summarized the federal law of disqualification of a district judge as follows:

“(1) The mere filing of an affidavit does not oust the judge from the cause.

“(2) The judge has the right to determine the legal sufficiency of the affidavit.

“(3) The bias or prejudice must be personal, i.e., antagonism or opposition to the litigant, or favoritism for his opponent.

“(4) Definite views on the law, adverse rulings in the case on trial, or adverse rulings against the suitor in other cases or in cases involving similar facts do not constitute such disqualification, *even in a criminal prosecution.*” 76 F. Supp. at pages 876-877. (Emphasis in original.)

See also *Los Angeles Trust Deed & Mortgage Exchange v. Security and Exchange Commission*, 285 F. 2d 162, 172-173 (9th Cir. 1960), cert. denied, 366 U. S. 919 (1961); *Taylor v. United States*, 179 F. 2d 640, 644 (9th Cir.), cert. denied, 339 U. S. 988 (1950); and *Ferrari v. United States*, 169 F. 2d 353, 355 (9th Cir. 1948 (“as a prerequisite to the disqualification of a judge personal bias must be shown, which has been held to be an attitude of extrajudicial origin”).

The allegations of the affidavit of prejudice and motion for the district judge to recuse himself at bar do not even remotely approach those in *Gladstein v. McLaughlin*, 230 F. 2d 762 (9th Cir. 1955) and *Connelly v. United States*, 191 F. 2d 692 (9th Cir. 1951), in which this court held that affidavits of prejudice adequately showed the personal bias and prejudice required by the statute. (See the summary of these two cases in *Los Angeles Trust Deed & Mortgage Exchange v. Securities and Exchange Commission*, *supra*, 285 F. 2d 162 at p. 173 nn. 5 and 6.)

Judge Pence's denial of appellant's motion that he recuse himself is also supported by decisions of the other courts of appeals. These decisions clearly show that neither the affidavit of Mr. Houston nor the affidavit of prejudice of Mrs. McPheeters allege sufficient facts to require Judge Pence to recuse himself.



In *Craven v. United States*, 22 F. 2d 605 (1st Cir. 1927), cert. denied, 276 U. S. 627 (1928), the defendant in a criminal case filed an affidavit of prejudice prior to his second trial before the same judge who had presided at his first trial. The affidavit alleged bias and prejudice of the district judge against defendant and in favor of the United States predicated on alleged conduct of the district judge at defendant's first trial. In holding that the affidavit of prejudice did not contain allegations of facts sufficient to require the district judge to disqualify himself from presiding at the second trial, the court of appeals characterized the affidavit as follows:

"All that is indicated is that at the first trial, on the basis of the evidence there adduced, the presiding judge acquired and exhibited before the jury (which nevertheless disagreed) a view that the defendant was guilty." 22 F. 2d at p. 607.

The court then held that "a general and epithetical charge of bias, by questions not set forth, is idle." *Ibid.* This holding is directly in point in the case at bar, as are these further statements of the court:

"At most, then, the affidavit charges a 'bias and prejudice,' grounded on the evidence produced in open court at the first trial, and on nothing else. We hold that such bias and prejudice (if these be appropriate terms for a well-grounded state of mind, 255 U. S. 42, 41 S. Ct. 236, 65 L. Ed. 481) is not personal; that it is judicial. 'Personal' is in contrast with judicial; it characterizes an attitude of extrajudicial origin, derived non coram iudice. 'Personal' characterizes clearly the prejudgment guarded against. It is the duty



of a real judge to acquire views from evidence. The statute never contemplated crippling our courts by disqualifying a judge, solely on the basis of a bias (or state of mind, 255 U.S. 42, 41 S. Ct. 236, 65 L. Ed. 481) against wrongdoers, civil or criminal, acquired from evidence presented in the course of judicial proceedings before him. Any other construction would make the statute an intolerable obstruction to the efficient conduct of judicial proceedings, now none too speedy or effective.” *Id.* at pages 607-608.

“If, as happened in many of the cases reported, this statute is permitted to be used by overzealous counsel, scanting their professional duty to the public weal and to the court as the protector of the public right, as a method of procuring delay (U. S. v. Fricke [D.C.] 261 F. 541), and in many instances a new trial before a judge who must approach, de novo, problems already considered by another judge (Ex parte Am. Steel Barrel Co., 230 U.S. 35, 44, 33 S. Ct. 1007, 57 L. Ed. 1379) the statute will leave immune from attack only the amorphous dummies reprobated by Mr. Justice McReynolds as unbecoming receptacles for judicial power (255 U. S. 43, 41 S. Ct. 236, 65 L. Ed. 481). Only the timid and the incompetent, if there be now or hereafter any such on the federal bench, will be free from attack under this statute.” *Id.* at page 608.

In *Gallarelli v. United States*, 260 F. 2d 259 (1st Cir. 1958), cert. denied, 359 U. S. 938 (1959), the Court in holding an affidavit of prejudice insufficient, stated:

“The courts have made it clear that a judge is obliged to remove himself only in the face of an af-

fidavit setting forth 'a personal bias or prejudice', as distinguished from a judicial predilection obtained from the hearing of a case. . . ." *Id.* at page 261.

In *Eisler v. United States*, 170 F. 2d 273 (D.C. Cir.), cert. granted, 335 U. S. 857 (1948), ordered off docket, 338 U. S. 189, cert. dismissed, 338 U. S. 883 (1949), the court of appeals held insufficient an affidavit of prejudice which alleged that the district judge was prejudiced against the defendant because of the judge's background and experience prior to assuming the bench. The court stated:

"[W]e consider it the duty of the judge, when the showing for recusation is insufficient, to remain in the case.

". . . Prejudice, to require recusation, must be personal according to the terms of the statute, and impersonal prejudice resulting from a judge's background or experience is not, in our opinion, within the purview of the statute." *Id.* at page 278.

In *Palmer v. United States*, 249 F. 2d 8 (10th Cir. 1957), cert. denied, 356 U. S. 914 (1958), the court in holding an affidavit of prejudice insufficient stated:

"The allegations contained in petitioner's affidavit are but complaint of adverse rulings made by the court and subjective conclusions as to the court's motives and manner in conducting the trial and subsequent proceedings. Such claims do not meet the requirements of 28 U.S.C.A. §144." 249 F. 2d at page 9.

See also:

*Refior v. Lansing Drop Forge Co.*, 124 F. 2d 440 (6th Cir.), cert. denied, 316 U. S. 671 (1942) (district judge has authority to pass on legal sufficiency of the affidavit of prejudice filed against him; “the dismissal of a cause of action, coupled with a showing of irritation of the trial judge at the time of the entry of the orders, are not sufficient foundation for . . . [recusation], otherwise a litigant could experiment as to the attitude of a trial judge and relitigate issues before another judge, to the annoyance and expense of parties with resulting delay in the disposal of cases”, *Id.* at page 445);

*Deitle v. United States*, 302 F. 2d 116, 118 (7th Cir. 1962) (an affidavit charging bias “predicated on the prior adverse rulings by the presiding judge” is insufficient);

*Ryan v. United States*, 99 F. 2d 864, 870-871 (8th Cir. 1938), cert. denied, 306 U. S. 635 (1939) (“judicial rulings cannot ordinarily be made the basis of a charge of bias or prejudice”).

The foregoing authorities clearly establish that Judge Pence in no way acted improperly in refusing to disqualify himself. The motion that he do so, the affidavit of Mr. Houston in support thereof, and the affidavit of prejudice of appellant McPheeters allege no facts showing “personal bias and prejudice” of Judge Pence against appellants, but are based on prior judicial proceedings and rulings in this case; they are patently and wholly insufficient as a matter of law.

Additionally, there are good procedural grounds supporting Judge Pence’s refusal to disqualify himself. The motion for disqualification and affidavit of preju-

dice were filed much too late, and the certificate of counsel is insufficient because it does not state counsel's good faith as distinguished from the affiant's good faith.

The statute requires that the affidavit of prejudice "shall be filed not less than ten days before the beginning of the term at which the proceeding is to be heard, or good cause shall be shown for the failure to file it within such time." 28 U. S. C. Sec. 144. In *In re United Shoe Machinery Corp.*, 276 F. 2d 77, 79 (1st Cir. 1960), the court pointed out that "one of the reasons for requiring promptness in filing [an affidavit of prejudice] is that a party, knowing of a ground for requesting disqualification, cannot be permitted to wait and decide whether he likes subsequent treatment that he receives." In *Pacheco v. People*, 300 F. 2d 759, 760 (1st Cir. 1962) the court stated: "If a judge is subject to disqualification, the party concerned must complain promptly. He cannot be allowed to wait to see how the judge decides."

In *In re Union Leader Corp.*, 292 F. 2d 381 (1st Cir.), cert. denied, 368 U. S. 927 (1961), the court held that the certificate of counsel accompanying an affidavit of prejudice must state counsel's good faith and assert that counsel believes the facts alleged in the affidavit are accurate and correct. 292 F. 2d at pages 384-385.

The court also pointed out in the *Union Leader* case that:

"[A] judge must be presumed to be qualified, and there must be a substantial burden upon the affiant to show grounds for believing the contrary." *Id.*, at page 389.



“There is as much obligation upon a judge not to recuse himself when there is no occasion as there is for him to do so when there is.” *Id.*, at page 391.

If, as appellants now claim, they believe that Judge Pence has a personal bias and prejudice against them because of what transpired at the hearing on Mr. Crumpacker’s motion for leave to withdraw as their counsel, they should have filed their affidavit of prejudice and moved to disqualify Judge Pence at least prior to the hearing of appellee’s motion to strike their notice of dismissal or grant dismissal on terms and conditions, not over two months after Judge Pence announced his ruling on appellee’s motion adverse to the appellants. [Judge Pence ruled on appellee’s motion and ordered that appellants’ dismissal stand, conditioned on payment of appellee’s costs, on September 17, 1962. Tr. p. 136. The formal written order (prepared by appellants’ counsel, Mr. Houston) was dated September 28, 1962 and filed October 1, 1962. Tr. pp. 65-66. The motion for Judge Pence to recuse himself was filed November 19, 1962. Tr. pp. 83-87. The affidavit of prejudice was filed November 29, 1962. Tr. pp. 90-93.]

The certificate of Mr. Houston annexed to the affidavit of prejudice states only that “in his opinion the Plaintiffs filed their Motion to disqualify Judge Martin Pence in the cause in good faith, honestly, believing said Judge to be prejudiced against them and that Plaintiff Georgia McPheeters made the foregoing affidavit in good faith reasonably believing the facts therein stated show prejudice on the part of Judge Martin Pence towards the Plaintiffs.” Nowhere does Mr. Houston certify either his good faith or his belief



that the facts stated in the affidavit of prejudice are accurate and correct.

For all the reasons discussed, Judge Pence in no way acted improperly or erroneously in refusing to disqualify himself. The motion that he do so and affidavit of prejudice were insufficient as a matter of law; they were untimely; and the certification of counsel required by the statute was insufficient.

## II.

### **The District Court Did Not Err in Dismissing This Action With Prejudice.**

The facts of the dismissal of this action with prejudice by the district court are simple although appellants' brief has obscured and obfuscated them. The principles of law pertaining to that dismissal are clear and settled. These facts and principles establish that the district judge acted within his discretion in dismissing this action with prejudice.

**A. The Order of the District Court Was That This Action Would Be Dismissed Without Prejudice Upon Appellants' Meeting the Conditions Imposed by the District Court and With Prejudice Only If Appellants Did Not Comply With Those Conditions.**

Appellants' purported notice of dismissal without prejudice of this action was filed August 30, 1962. [Tr. pp. 61-62.] This notice of dismissal was filed *after* appellee had incurred substantial expense in preparing her defense to this action; *after* appellee had taken the deposition of appellant Georgia McPheeter; *after* appellee had incurred substantial unnecessary expense in connection with Mrs. McPheeter's deposition caused solely by her deciding after her deposition had been set for

Los Angeles, the city of her residence, to have her deposition taken in Honolulu; and *after* appellee had filed a motion to dismiss this action which was to be based in part on matters outside the pleadings. This notice of dismissal was also filed after appellants had served interrogatories on appellee and after appellee had answered those interrogatories. [For the substantial expense incurred by appellee in preparing a defense to this action, and the unnecessary additional expense caused appellee by appellant McPheeter, see the Memoranda of Costs and Attorneys Fees filed November 1, 1962 and November 8, 1962, the Affidavit of Howard S. Smith re Costs and Legal Fees Incurred by Defendant filed November 8, 1962, and the Supplemental Affidavit of Howard S. Smith re Employment of Firm of Mitchell, Silberberg & Knupp, filed December 12, 1962. Tr. pp. 67-72, 73-78, and 109-113. The district court's docket indicates that appellants filed written interrogatories to appellee on January 31, 1962, and that answers to these interrogatories were filed on February 26, 1962, and an amended answer filed on March 19, 1962. Tr. p. 49.]

Appellee's motion to dismiss or for more definite statement was filed June 15, 1962 [Tr. pp. 53-56]; on July 2, 1962, the deposition of appellant McPheeters was filed. [Tr. p. 49.]

On September 7, 1962, appellee filed a motion to strike appellants' notice of dismissal or to grant dismissal only on such terms and conditions as the court deemed just and reasonable. [Tr. pp. 63-64.] The hearing on this motion was on September 17, 1963. At that time the court ordered "that the notice of dismissal stand, conditioned upon the payment to defendant of

his costs.” [Tr. p. 136.] The formal order to that effect, prepared by Brahan Houston, appellant’s counsel, expressly provided “that this cause may stand dismissed pursuant to plaintiff’s Notice to Dismiss [*i.e. without prejudice*], on the condition that plaintiffs pay defendant his costs, including attorneys’ fees, incurred herein.” [Tr. p. 66.]

On November 8, 1962, a further hearing was had on the matter of the costs and expenses to be paid by appellants as the condition to dismissal without prejudice. The court began that hearing with the statement that the only basis for a dismissal was under Rule 41(a)(2) of the Federal Rules of Civil Procedure and that “unless otherwise specified in the order of dismissal under this paragraph, *it is without prejudice.*” [Tr. p. 176, lines 3-10. Emphasis supplied.]

A written supplemental order on appellee’s motion to strike appellants’ notice of dismissal was signed and filed November 29, 1962 [Tr. pp. 94-95]; this order was amended in open court on December 19, 1962 [Tr. pp. 50-51, 138 and 202]. As so amended this supplemental order provides:

“IT IS HEREBY ORDERED that the Plaintiffs jointly and severally pay to the Defendant or his legal successor within thirty (30) days from the entry hereof, the sum of FOUR THOUSAND NINE HUNDRED SIXTY SEVEN AND 25/100 DOLLARS (\$4,967.25) for costs and attorneys’ fees incurred by Defendant in this matter; and in the event the Plaintiffs shall fail to meet this condition, this cause will stand dismissed with prejudice for failure to comply with terms and conditions of court.”

It is therefore clear beyond doubt that the order of the district court was that this action would be dismissed *without prejudice* upon appellants' meeting the conditions imposed by the court, and with prejudice *only* should appellants not meet those conditions. That this was the intention of the district judge is shown by part of the colloquy between him and Mr. Houston on December 19, 1962. [See Tr. p. 201, line 22, to p. 203, line 6.]

This colloquy in part is as follows:

“Mr. Houston: Your Honor has ruled that the case be dismissed with prejudice under your Honor's inherent jurisdiction to do so.

The Court: Well, that is if the terms aren't met, yes.

Mr. Houston: Well, now, that means that your Honor would be dismissing with prejudice for the failure of the plaintiffs to meet the terms of the Order.

The Court: Yes.” [Tr. p. 201, line 22, to p. 202, line 4.]

“The Court: Yes. I will delete from the supplemental order of November 29th, the words ‘For failure to prosecute,’ and rather, the wording will be ‘For failure to comply with the terms and conditions fixed by the court.’” [Tr. p. 202, lines 19-22.]



**B. The District Court Had Discretion to Order That This Action Could Be Dismissed by Appellants Without Prejudice Only on Just and Reasonable Terms and Conditions.**

Rule 41(a)(1) of the Federal Rules of Civil Procedure limits the absolute right of a plaintiff to a voluntary dismissal without prejudice by requiring that such a dismissal may be had only “at any time before service by the adverse party of an answer or of a motion for summary judgment.”

Rule 41(a)(2) provides that after a filing of an answer or motion for summary judgment “an action shall not be dismissed at the plaintiff’s instance, save upon order of the court and upon such terms and conditions as the court deems proper.”

While the motion filed by appellee was denominated a motion to dismiss, the district court and all parties treated it as a motion for summary judgment under that portion of Rule 12(b) which provides that if on a motion to dismiss matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment. Appellants have never contended to the contrary. The motion referred to matters outside the pleadings since it was made on the grounds, among others, of laches, the statute of limitations and that appellant’s claim “is entirely conjectural and without any foundation in fact” [Tr. pp. 54-55], and the deposition of appellant McPheeters was filed for use by the court in connection with the hearing and determination of that motion.

While Rule 41(a)(1) refers to an answer or motion for summary judgment as cutting off the absolute right of a plaintiff to a voluntary dismissal, the cases have



construed that section as terminating that right upon the filing of a motion or pleading raising substantial issues on the merits not raised by the complaint. In *Harvey Aluminum Inc. v. American Cyanamid Co.*, 203 F. 2d 105, 107-108 (2d Cir.), cert. denied, 345 U. S. 964 (1953) the court stated the purpose of Rule 41(a) as follows:

“The purpose of this rule is to facilitate voluntary dismissals, but to limit them to an early stage of the proceedings before issue is joined. 5 Moore’s Fed. Practice 1007 (2d ed.). The amount of research and preparation required of defendants was stressed by the Committee Note when Rule 41-(a) 1 was amended in 1948 as a reason for adding the reference to a motion for summary judgment. 5 Moore’s Fed. Practice 1005 (2d ed.) . . . . Consequently, although the voluntary dismissal was attempted before any paper labeled ‘answer’ or ‘motion for summary judgment’ was filed, a literal application of Rule 41(a) 1 to the present controversy would not be in accord with its essential purpose of preventing arbitrary dismissals after an advanced stage of a suit has been reached.”

See also:

*Littman v. Bache & Co.*, 252 F. 2d 479 (2d Cir. 1958).

In the *Harvey Aluminum* case it was held that a motion for preliminary injunction which had been briefed, argued and determined barred plaintiff’s right to a voluntary dismissal even though no answer or motion for summary judgment had been filed.

In *Butler v. Denton*, 150 F. 2d 687 (10th Cir. 1945) it was held that the filing of a plea in intervention which tendered justiciable issues barred plaintiff's absolute right to a voluntary dismissal even though no answer or motion for summary judgment had been filed.

It has been squarely held that a motion to dismiss which raises the issue of the statute of limitations, as does the motion to dismiss filed by appellee here, should be considered an answer for the purposes of Rule 41(a). *Baker v. Sisk*, 1 F. R. D. 232 (E.D. Okla., 1938). It has also been squarely held that a motion to dismiss for failure to state a claim upon which relief can be granted should be regarded as the equivalent of a motion for summary judgment for the purpose of applying Rule 41(a), especially where, as in this case, that motion is one that could have been treated as one for summary judgment under Rule 12(b). *Tele-Views News Co. v. S.R.B. TV Publishing Co.*, 28 F. R. D. 303, 306-308 (E.D. Pa., 1961).

Under any of the foregoing criteria, the district court's refusal to permit appellants to dismiss without prejudice without the imposition of terms and conditions was correct. Appellee had incurred substantial expense to prepare her defense to this action. Substantial discovery had taken place. A motion that was obviously intended to be a motion for summary judgment, although denominated a motion to dismiss, had been filed. That motion raised substantial issues going to the merits of this action, including laches, the statute of limitations, failure of appellants to return property already received as required by law, and that the action was "without any foundation in fact."

*Kilpatrick v. Texas & P.R.R.*, 166 F. 2d 708 (2d Cir.), cert. denied, 335 U. S. 814 (1948) is not applicable to this case. The motion which was there held insufficient to bar plaintiff's absolute right to a voluntary dismissal without prejudice was a motion seeking dismissal because of lack of jurisdiction over the person of defendant. The court there pointed out that such a motion set up no matter introducing issues not raised by the complaint. 150 F. 2d at page 687. The motion filed in this case, however, raised issues going directly to the merits of the controversy.

The district court unquestionably has broad discretion in devising and imposing terms and conditions of a dismissal without prejudice under Rule 41(a)(2). See *American Cyanamid Co. v. McGhee*, 217 F. 2d 295, 298 (5th Cir. 1963); *Blue Mountain Construction Co. v. Werner*, 270 F. 2d 305 (9th Cir. 1959), cert. denied, 361 U. S. 931 (1960); *Standard Natl. Ins. Co. v. Bayless*, 272 F. 2d 185 (5th Cir. 1959); *Diamond v. United States*, 267 F. 2d 23 (5th Cir.), cert. denied, 361 U. S. 834 (1959). This discretion includes the right to impose as a condition of dismissal the payment by plaintiff of defendant's attorneys' fees. *Federal Savings and Loan Ins. Corp. v. Reeves*, 148 F. 2d 731 (8th Cir. 1945), in which an award of attorneys' fees and expenses in the amount of \$6,741 was held within the lawful discretion of the trial court; *New York C. & St. L. R.R. v. Jardaman*, 181 F. 2d 769, 771 (8th Cir. 1950). See for a general discussion, 5 Moore, *Fed. Practice* ¶41.06 (2d ed.). That the district judge carefully weighed the evidence presented to him in exercising his discretion and assessing the amount of costs to be paid by appellants is shown by his statements

in open court on the subject. [Tr. pp. 176-181; 192, line 8, to 194, line 24.]

**C. The District Court Did Not Err in Dismissing This Action With Prejudice When Appellants Failed to Meet the Conditions Imposed by the Court.**

The order of the district court directing that this action be dismissed with prejudice for failure of appellants to comply with the conditions imposed by the court was correct. Identical orders have been upheld without any question of their propriety. In *De Filippis v. Chrysler Sales Corp.*, 116 F. 2d 375 (2nd Cir. 1940) plaintiff was permitted to dismiss without prejudice

“upon condition that the appellant (plaintiff) pay to the appellee (defendant) two hundred and fifty dollars within thirty days with the proviso ‘that in the event no such payment is made, this cause be and the same is hereby dismissed on the merits and with prejudice to any further suit on the patent herein, with respect to the devices complained of herein’.” 116 F. 2d at p. 376.

Plaintiff did not meet the condition imposed by the court and a judgment of dismissal with prejudice was ultimately entered. In affirming this judgment the court of appeal stated:

“When the time for the payment of the terms imposed expired without compliance with the order the entry of an order which took cognizance of that fact and dismissed the suit would have done away with any possible doubt as to whether and when a final order had been made.” *Ibid.*

In *Stern v. Inter-Mountain Telephone Co.*, 226 F. 2d 409 (6th Cir. 1955), an order requiring the plaintiff to



pay certain expenses and permit his deposition to be taken as conditions to a dismissal without prejudice and ordering that the dismissal be with prejudice for failure to meet those conditions was held to be clearly within the scope of Rule 41(a). A judgment of dismissal with prejudice for failure of plaintiff to comply with these conditions was affirmed.

**D. The District Court Did Not Err in Refusing to Set Aside Its Order of Dismissal.**

Appellants filed various motions and papers in the district court which in effect sought to have the district court set aside its orders permitting this action to stand dismissed on the payment of costs and expenses and reinstate this action. Appellants made no showing whatsoever that would require the district court to grant such motions. Indeed, appellants' conduct throughout this litigation has been such as to wholly justify the action of the district court. They have persistently and maliciously maligned and abused the district judge. They vexatiously multiplied expenses in this action. They filed a complaint against appellee and another in the Hawaii State Court, based on the same claim asserted in this action, which was indecent and scandalous. They then dismissed the State Court action voluntarily and later sought to revive it against appellant. They did not even attempt to make any showing that their claim in this action is meritorious to support their request that the district court set aside its orders. Appellants' conduct throughout the proceedings in the district court and, we submit, in this court, have shown a bent and determination by them to abuse and misuse the judicial process to vent their unfounded spleen on the district judge and on appellee's decedent, the late Governor Stainback.



### Conclusion.

For all the reasons above stated, we submit that the district judge committed no error. Appellants have not made any showing that the district judge in any way abused any discretion reposed in him. The judgment below should therefore be affirmed.

Respectfully submitted,

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HOWARD S. SMITH,  
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KATSURO MIHO,

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*Attorney for Appellee.*

### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

HOWARD S. SMITH,  
*Attorney for Appellee.*



No. 18634

IN THE

United States Court of Appeals  
FOR THE NINTH CIRCUIT

---

LEAR SIEGLER, INC., a corporation,

*Appellant,*

*vs.*

JOHN S. ADKINS,

*Appellee.*

---

On Appeal From the United States District Court for the  
Southern District of California, Central Division.

---

Appellant's Opening Brief on Appeal and on Request  
for Writ of Mandamus.

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**FILED**

**AUG 14 1963**

FRANK H. SCHMID, CLERK





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## Jurisdictional Statement.

This appeal is in an action where the jurisdiction of the United States District Court for the Southern District of California, Central Division, was based on 28 United States Code, Section 1338, relating to patent causes, on 28 United States Code, Section 1331, relating to the amount in controversy, and on 28 United States Code, Section 2201, relating to declaratory judgments.

The jurisdiction of this Court is based on 28 United States Code, Section 1292, and on 28 United States Code, Section 1651.

The complaint [Tr. 2] in the District Court proceedings sets forth the basis for the District Court's jurisdiction. The Order Relating to Stay of All Fur-



ther Proceedings [Tr. 88] sets forth the basis for this Court's jurisdiction under 28 United States Code, Section 1292(b). In the order the District Court stated that the order involves a controlling question of law as to which there is ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation. The Order Relating to Stay of All Further Proceedings is tantamount to an injunction against further proceedings until a final determination of a state court action and thereby provides a basis for this Court's jurisdiction under 28 United States Code, Section 1292(a) also. The Order Relating to Stay of All Further Proceedings [Tr. 88] also shows the basis for this Court's jurisdiction under 28 United States Code, Section 1651, because the order stays all further proceedings in the District Court until a final determination of a state court action, whereas the jurisdiction of the District Court is exclusive of the courts of the states in patent cases under 28 United States Code, Section 1338. A writ is necessary in aid of the jurisdiction of this Court and of the District Court over patent cases.

### **Statement of the Case.**

Appellant filed a complaint for declaratory judgment on March 1, 1963 in the United States District Court for the Southern District of California, Central Division, Civil Action No. 63-241-Y. The complaint seeks a declaratory judgment of invalidity, unenforceability, and non-infringement of United States Letters Patent 2,919,586. [Tr. 2.]

Appellee moved for a stay of all further proceedings in the declaratory judgment action because of an ac-

tion in the Superior Court of the State of California in and for the County of Los Angeles, No. 737,267. [Tr. 11.] No answer to the complaint has been filed.

On April 9, 1963 the Honorable Leon R. Yankwich entered the following order:

“IT IS ORDERED that the Motion of the Defendant to Stay all Further Proceedings herein until final adjudication in that certain action now pending between the same parties hereto in the Superior Court of the County of Los Angeles, entitled JOHN S. ADKINS, Plaintiff v. LEAR, INCORPORATED, ET AL., Defendants, being Case No. 737,267 therein, is hereby granted.

“The Court finds that this Order involves a controlling question of law as to which there is ground for difference of opinion and that an immediate appeal from this order may materially advance the ultimate termination of this litigation.” [Tr. 88-89.]

The complaint in the Superior Court action alleges breach of contract as a first cause of action and misappropriation as a second cause of action. [Tr. 20.] The Superior Court action was filed on January 5, 1960, and is presently in the discovery stage.

The complaint in the Superior Court action alleges that the parties to the present suit entered into a license agreement concerning certain products and developments. [Tr. 21.] Said license agreement concerned an issued United States Letters Patent No. 2,542,975 and an application for patents covering the inventions of certain exhibits to the agreement to the extent that such inventions are patented or patentable to appellee. [Tr. 27-30.] Patent Application Serial

No. 410,237 is one of said exhibits, and it issued as United States Letters Patent No. 2,919,586 on January 5, 1960. [Tr. 59-60.] The other issued patent No. 2,542,975 is not in controversy.

The license agreement provided in Section 2(a) that appellant shall have the right on ninety days' prior written notice to terminate any one or more of the licenses which were granted under the agreement. [Tr. 30.] The license agreement provided in Section 6 that in the event the U. S. Patent Office refuses to issue a patent on the substantial claims of the patent applications, such as patent application Serial No. 410,237, then appellant may at its option forthwith terminate the entire license agreement and no further royalties shall thereupon be payable under the license agreement. [Tr. 37.]

Appellant gave written notice of termination of the license agreement under Sections 2(a) and 6 of the agreement. The written notice was on April 8, 1959. [Tr. 66.]

Appellee alleges that appellant continues to manufacture and sell products for which royalties are required under said license agreement [Tr. 23], and this is the basis for appellee's alleged cause of action in the state court for breach of contract. [Tr. 20-23.]

Appellee's alleged cause of action for misappropriation is based upon the alleged appropriation of his ideas, discoveries, and inventions by appellant. [Tr. 23-25.]

In view of appellant's termination of the license agreement exactly in accordance with the express provisions of the license agreement, appellant asserts that

there is no possible cause of action for breach of contract with respect to appellant's activities subsequent to the termination of the license agreement. [Tr. 60-61.] Appellant also asserts that there is no possible cause of action for misappropriation. [Tr. 41, 87.]

Accordingly, appellant asserts that any rights which appellee may have must be based upon statutory patent rights.

Appellee asserts that most or all of the issues in the present action will be resolved in the state court action [Tr. 70], and that infringement of Patent No. 2,919,586 will be in issue only if the state court action is unsuccessful. [Tr. 18.]

Appellant asserts that most or all of the issues in the present action will not be resolved in the state court action, that the state court proceedings probably will run for several years, and that a prompt adjudication of validity, infringement and enforceability of Patent No. 2,919,586 is necessary to ascertain the rights of the parties under the patent laws and to protect appellant from a long delay in clarifying these rights. [Tr. 61, 84-87.]

Appellant also asserts that adjudication of validity, infringement and enforceability of Patent No. 2,919,586 is under the original jurisdiction of the District Court to the exclusion of the state court, and that this Court should direct the District Court to try these issues in order to retain its exclusive jurisdiction over patent cases. This Court should act in order to protect its potential appellate jurisdiction.



### **Specification of Errors.**

1. The District Court erred as a matter of law in granting an order to stay all further proceedings until final adjudication of another action now pending between the parties hereto in the Superior Court of the County of Los Angeles.
2. The District Court abused its discretion in granting an order to stay all further proceedings until final adjudication of another action now pending between the parties hereto in the Superior Court of the County of Los Angeles.

### **Summary of Argument.**

The stay of all further proceedings in this action is in error as a matter of law because this action pertains to matters in which the District Court has original jurisdiction and such jurisdiction is exclusive of the state court. The District Court should conduct the trial of this action promptly in order to protect its own jurisdiction.

The stay of all further proceedings in this action is in error or constitutes an abuse of discretion by the District Court because the pending state court action cannot resolve all of the issues of the present case.

The stay by the District Court constitutes an interlocutory decision and order over which this Court has jurisdiction. The District Court was of the opinion that the order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation.

The stay by the District Court constitutes an abuse of discretion by the District Court over which this Court has jurisdiction.



## ARGUMENT.

### I.

#### The District Court Has Exclusive Jurisdiction Over Patent Cases and Cannot Properly Stay the Present Patent Case Until Final Adjudication of the State Court Action.

With reference to the jurisdiction of the courts over patent cases, the patent laws provide:

28 U. S. C. 1338(a). "The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents, copyrights and trade-marks. Such jurisdiction shall be exclusive of the courts of the states in patent and copyright cases."

The present action is a civil action arising under an Act of Congress relating to patents. The present action seeks an adjudication of invalidity and non-infringement of the U. S. Patent No. 2,919,586 and also seeks an adjudication that the patent is unenforceable. The validity of the patent is subject to the conditions set forth in 35 U. S. C. 100-188. Infringement of the patent is subject to the provisions of 35 U. S. C. 271-293. Enforceability of the patent is subject to the provisions of 35 U. S. C. to the provisions of the antitrust laws 15 U. S. C. 1-15, and to the provisions of the common law.

The Patent Office was established to administer the patent laws enacted by Congress in accordance with Article I, Section 8 of the Constitution.

The *Rules of Practice of the United States Patent Office in Patent Cases* state:

"56. Improper applications. Any application signed or sworn to in blank, or without actual in-

spection by the applicant, and any application altered or partly filled in after being signed or sworn to, and also any application fraudulently filed or in connection with which any fraud is practiced or attempted on the Patent Office, may be stricken from the files.”

The present action involves all of the Acts of Congress set forth above. In accordance with the provisions of 28 U. S. C. 1338(a) the District Court has original jurisdiction and such jurisdiction is exclusive of the state courts.

The present action also involves the declaratory judgment statutes. The primary statute states:

28 U. S. C. 2201. “In a case of actual controversy within its jurisdiction, except with respect to Federal taxes, any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.”

Obviously there is an actual controversy concerning U. S. Patent No. 2,919,586. Appellee asserts that the validity and the scope of the patent are in controversy. [Tr. 48.] Moreover, the complaint in the state court action and the supporting license agreement place the validity and scope of the patent in issue because the license agreement defines inventions as those that are patented or patentable [Tr. 29] and the license agree-

ment grants rights under claims which have been patented or which will be patentable. [Tr. 30.]

The scope of the patent is determinative of whether or not there is infringement. The statutory provision defines infringement as follows:

35 U. S. C. 271(a). "Except as otherwise provided in this title, whoever without authority makes, uses or sells any patented invention, within the United States during the term of the patent therefor, infringes the patent."

Infringement is determined by the claims of the patent interpreted in the light of the description of the invention in the specification of the patent. *Schmitzer et al. v. California Corrugated Culvert Co. et al.* (9th Cir., 1944), 140 F. 2d 275. *Fulton Co. v. Powers Regulator Co.* (2nd Cir., 1920), 263 Fed. 578. *General Motors Corporation v. Kesling* (8th Cir., 1947), 164 F. 2d 824.

Where the nature of the patented invention and the alleged infringing device are clear, the question of infringement is a question of law. *Kwikset Locks, Inc. v. Hillgren* (9th Cir., 1954), 210 F. 2d 483.

In addition, appellee has stated in the pleadings that he will charge appellant with infringement if the state court action is unsuccessful. [Tr. 18.] This is a threat to bring infringement proceedings on the patent, and as such places the matter in controversy within the meaning of the declaratory judgment statute, 28 U. S. C. 2201; *Crowell v. Baker Oil Tools, Inc. et al.* (9th Cir. 1944), 143 F. 2d 1003.

In *Girdler Corporation v. E. I. Du Pont de Nemours & Co.* (D. C. Del. 1944), 56 F. Supp. 871, 875, the court stated:

“The mere assertion of adverse rights evidences the existence of a justiciable controversy between the owner of the patent and the declaratory judgment plaintiff.”

In *Grip Nut Co v. Sharp* (7th Cir. 1941), 124 F. 2d 814, 815 the court stated:

“Today, the alleged infringer once he is threatened by a patentee, has a remedy by complaint for a Declaratory Judgment. Now, . . . ‘the controversy between the parties as to whether a patent is valid, and whether infringement exists is in either instance essentially one arising under the patent laws of the United States.’ ”

Thus, there is an actual controversy as to the validity, scope, infringement, and enforceability of the patent in question. This controversy probably will take several years to resolve if the proceedings in the District Court are stayed pending a final adjudication in the state court action. [Tr. 84.] The controversy involves a large sum of money, and a long delay in resolving the controversy would place an intolerable burden on appellant. [Tr. 87.] The controversy involves a matter over which the District Court has original jurisdiction exclusive of the state court. Hence the District Court should not stay its proceedings, but rather, it should act promptly in order to protect its jurisdiction.

Very similar issues concerning the administration and enforcement of Acts of Congress were presented



in *Lyons et al. v. Westinghouse Electric Corporation* (2nd Cir. 1955), 222 F. 2d 184.

The *Lyons* case involved the antitrust acts and the stay of a District Court action pending final judgment in a state court action between the same parties.

The court summarized the issue as follows:

“Thus the inquiry comes down to whether, when Congress gave exclusive jurisdiction to the district court over wrongs committed under the Anti-Trust Acts, it only meant that the ‘person who shall be injured’ must sue in the district court to recover damages; or whether it also meant that the district court must have unfettered power to decide the claim, regardless of the findings of any other courts, even when these were essential to the decision of actions over which their jurisdiction was unquestioned.” 222 F. 2d 184, 188.

The court decided this issue as follows:

“In the case at bar it appears to us that the grant to the district courts of exclusive jurisdiction over the action for treble damages should be taken to imply an immunity of their decisions from any prejudgment elsewhere; at least on occasions, like those at bar, where the putative estoppel includes the whole nexus of facts that makes up the wrong. The remedy provided is not solely civil; two thirds of the recovery is not remedial and inevitably presupposes a punitive purpose. It is like a *qui tam* action, except that the plaintiff keeps all the penalty, instead of sharing it with the sovereign. There are sound reasons for assuming that such recovery should not be subject



to the determinations of state courts. It was part of the effort to prevent monopoly and restraints of commerce; and it was natural to wish it to be uniformly administered, being national in scope. Relief by certiorari would still exist, it is true; but that is a remedy burdensome to litigants and to the Supreme Court, already charged with enough. Obviously, an administration of the Acts, at once effective and uniform, would best be accomplished by an untrammelled jurisdiction of the federal courts.” 222 F. 2d 184, 189.

This Court recently decided a very similar issue to that presented by the present case in *Mach-Tronics, Incorporated v. The Honorable Alfonso J. Zirpoli* (9th Cir. 1963), 316 F. 2d 820.

The *Mach-Tronics* case also involved the administration and enforcement of Acts of Congress—the anti-trust laws. The propriety of a stay of a District Court action until completion of all proceedings in a state court action, or “until further order of this court” was under consideration.

The stay in the present action is even more restrictive because it is to stand until final adjudication in the state court without any proviso for further order of the court.

This Court held that the stay in the *Mach-Tronics* case was improper because the federal court had exclusive jurisdiction. This Court considered whether or not the judgment of the state court would operate as an estoppel and stated:

“But let us suppose that such a determination in the state court would operate as an estoppel. That

in our view would constitute an additional reason for the respondent court to proceed without delay with the hearing and determination of the case presented by petitioner's complaint." 316 F. 2d 820, 832-833.

\* \* \* \* \*

"We have noted here the congressional policy to entrust to the federal district courts the determination of questions of fact and law in treble damage suits brought pursuant to § 15. We think it to be a part of our function to see that this policy, entrusted to the courts, is not frustrated or abandoned." 316 F. 2d 820, 834.

In *Propper v. Clark* (1948), 337 U. S. 472, the Supreme Court considered another Act of Congress—the Trading with the Enemy Act of 1917—and related actions in a state court and in a Federal court. The court considered matters involving both the Act of Congress and state laws and stated:

"Furthermore, as the state court could reasonably require complete adjudication of the controversy, the District Court would perhaps be compelled to stay proceedings in the state court to protect its own jurisdiction. 28 USC 1948 ed § 2283. Otherwise in sending a fragment of the litigation to a state court, the federal court might find itself blocked by res judicata with the result that the entire federal controversy would be ousted from the federal courts where it was placed by Congress." 337 U. S. 472, 491-492.

\* \* \* \* \*

“We reject the suggestion that a decision in this case in the federal courts should be delayed until the courts of New York have settled the issue of state law.” 337 U. S. 472, 492.

The present case involves an Act of Congress like the *Lyons*, *Mach-Tronics* and *Propper* cases. The present case involves the administration and enforcement of laws over which the Federal courts have exclusive jurisdiction, just as in the *Lyons* and *Mach-Tronics* cases. The present case involves a stay until final adjudication in the state court without any provision for requesting the District Court to reopen the case and hence is a more flagrant violation than was the *Mach-Tronics* case.

The stay should be removed in the present case just as it was in the *Lyons*, *Mach-Tronics* and *Propper* cases because an Act of Congress is controlling and because exclusive jurisdiction is in the District Court.

## II.

### **The Issues in This Action Are Governed Primarily by Acts of Congress and There Are No Controlling Issues of State Law.**

The patent laws were enacted by Congress and the Patent Office was established to administer the patent laws in accordance with Article I, Section 8 of the Constitution.

The present action contests the validity of U. S. Patent No. 2,919,586 [Tr. 4], it contests infringement of the patent [Tr. 7], and it contests the enforceability of the patent because of the antitrust laws. [Tr. 8.] These issues are governed by Acts of Congress and not by state laws.

The validity and enforceability of the patent in question affects the public of the United States because the patent was issued by the United States Government and has nation-wide effect. Hence, validity and enforceability are primarily federal questions.

Appellee asserts that appellant is estopped to contest the patent in question because of a license agreement between the parties. [Tr. 70-72.]

However, the license agreement related to the application for the patent in question and it was terminated by appellant before the patent issued and before any of the patent claims in issue were allowed by the Patent Office. [Tr. 66.]

Appellant complied with the express provisions in the agreement and hence the agreement was terminated. There can be no estoppel of any kind and there can be no implied obligation to cease manufacturing.

“We recognize, of course, the rule by which a patent licensee may be estopped during the term of the license to dispute the validity of the patent, but we are of the view that it has no application where the licensee effects a valid cancellation of the license agreement, as was done here.”

*Michle Printing Press & Mfg. Co. v. Publication Corporation* (7th Cir. 1948), 166 F. 2d 615, 618.

“That being out of the case, we can find no ground on which to restrain the manufacture and sale by the appellants of the articles mentioned. It may expose the appellant to a suit for infringement, but that, as we have said, is foreign to the purpose of the present suit. Aside from the patent, there



is nothing to prevent the appellant from selling the same kind of goods as it sold during the term of the contract.”

*Stimpson Computing Scale Co. v. W. F. Stimpson Co.* (6th Cir. 1900), 104 Fed. 893, 897.

The issues concerning estoppel and implied obligations do not involve any particular state law or state constitutional provision. These issues involve common law and equitable principles. In other words, there are no controlling issues of state law. The primary issues are governed by federal law, and hence the District Court should try the issues of validity, infringement and enforceability.

The whole nexus of issues pertaining to the patent in suit is involved in the federal court action, whereas only the issues of breach of contract and misappropriation are involved in the state court action.

Where there are controlling issues of state law, some courts have held it proper to stay a federal action. Such issues have involved particular state laws, state constitutional questions, state regulatory officers, real property located within a state, and the public policy of a state. However, no such issues are involved in the present case. This in itself is sufficient to justify the removal of the stay in the present case. *Mach-Tronics, Incorporated v. The Honorable Alfonso J. Zirpoli* (9th Cir. 1963), 316 F. 2d 820, 827.



III.

**The Order of the District Court Is an Appealable Order.**

The order of the District Court which stays all further proceedings until final adjudication of an action in the state court is tantamount to an injunction. As such it is an appealable interlocutory decision under 28 U. S. C. 1292(a). *Adrian Ettelson et al. v. Metropolitan Life Insurance Company* (1942), 317 U. S. 188.

In any event the Order is appealable under 28 U. S. C. 1292(b) because the District Court stated that the order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation. The question of law is whether the District Court should act to protect its jurisdiction over a patent case or whether it should await the outcome of a state court action which might create a *res judicata* situation.

IV.

**This Is an Exceptional Case Warranting a Writ of Mandate in Aid of the Jurisdiction of This Court and of the District Court.**

The Patent Laws provide that the District Court has original jurisdiction over patent cases to the exclusion of state courts. 35 U. S. C. 1338.

The state court action now pending between the parties to this appeal involves United States Patent No. 2,919,586 in a direct manner. [Tr. 59.] Appellee contends that the state court action probably will determine all of the issues concerning this patent

or will result in this action, which is the subject of this appeal, becoming moot. [Tr. 49.]

Thus appellee is asserting that the state court action will resolve or render moot the issues of validity, infringement and enforceability of U. S. Patent No. 2,919,586—which matters are under the original jurisdiction of the District Court to the exclusion of state courts.

In other words, appellee is seeking to deprive this Court of its potential appellate jurisdiction over a patent case, and appellee is seeking to deprive the District Court of its original and exclusive jurisdiction of the patent case.

A Court of Appeals is empowered to direct a District Court to vacate a stay order which may have the effect of frustrating a potential appellate jurisdiction in the Court of Appeals to adjudicate the question involved. *McClellan v. Carland* (1910), 217 U. S. 268.

The District Court already has jurisdiction over the action.

“. . . mandamus in the United States courts is an ancillary remedy to be utilized only in the exercise of a jurisdiction already acquired. . . . the New Rules of Civil Procedure, 28 U.S.C.A. . . . enable the courts of the United States to grant relief upon a showing of facts entitling a plaintiff to relief even though he does not pray the precise relief to which he is entitled.” *C.D. Mathews Estate, Inc. v. Olive Branch Drainage* (7th Cir. 1950), 185 F. 2d 53, 54, 55.

With reference to writs of mandamus, this Court in *Hartley Pen Company v. United States District Court* (9th Cir. 1961), 287 F. 2d 324 stated:

“In our view the remedy is available in an ordinary case within our jurisdiction if ordinary remedies are inadequate and there are present exceptional and extraordinary circumstances which require the issuance of an extraordinary writ to prevent a grave miscarriage of justice.”

This Court also stated in *Butler v. Judge of United States District Court* (9th Cir. 1941), 116 F. 2d 1013 that:

“The pendency of the same cause of action in a state court between the same parties is ordinarily not a ground for abatement of the action in the federal court.”

The present case presents extraordinary circumstances in that the stay of proceedings in the District Court may permit a state court to adjudicate substantial issues concerning the validity, infringement and enforceability of U. S. Patent 2,919,586. The stay deprives the District Court of its original and exclusive jurisdiction and it deprives this Court of its potential appellate jurisdiction.

If the remedy afforded by appeal under 28 U. S. C. 1292 should be improper or inadequate, it is requested that this Court issue a writ of mandate under the liberal interpretation of the Rules of Judicial Procedure —28 U. S. C.

V.

**Conclusion.**

The stay of all further proceedings in the District Court should be removed in order to protect the jurisdiction of the District Court over patent cases and in order to protect this Court's potential appellate jurisdiction.

The stay of all further proceedings in the District Court should be removed because the issues involved in the proceedings are governed primarily by Acts of Congress and there are no controlling issues of state law.

The stay of all further proceedings in the District Court should be removed in order to resolve the controversy concerning U. S. Patent No. 2,919,586 at an early date. The validity and enforceability of this patent affect the general public of the United States as well as the parties hereto.

The District Court erred as a matter of law and abused its discretion in ordering a stay of all further proceedings until final adjudication of a state court action.

This Court is requested to correct the error of law and the abuse of discretion by directing the District Court to remove the stay.

Respectfully submitted,

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### **Certificate.**

I certify that in connection with the preparation of this brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

C. RUSSELL HALE





No. 18634

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

LEAR SIEGLER, INC., a corporation,

*Appellant,*

*vs.*

JOHN S. ADKINS,

*Appellee.*

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## APPELLEE'S BRIEF.

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---

## APPELLEE'S BRIEF.

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### I.

#### Jurisdictional Statement.

Plaintiff-appellant Lear-Siegler, Inc. (hereinafter referred to as "Lear") purports to base its appeal from the order of the District Court on 28 United States Code Sections 1292 Subd. (a) and 1292 Subd. (b). With respect to Section 1292 Subd. (a) Lear argues that "the order relating to stay of all further proceedings is tantamount to an injunction against further proceedings . . . and thereby provides a basis for this court's jurisdiction under 28 United States Code, Section 1292-(a) . . ." (O. B. p. 2).<sup>1</sup>

The same argument was considered and rejected in *Lyons v. Westinghouse Electric Corporation* (1955, Cir. 2), 222 F. 2d 184 where the court held that an order temporarily staying an action pending the outcome

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<sup>1</sup>O. B. will be used to refer to appellant's opening brief.

of a prior state court action is not the equivalent of an injunction and therefore not appealable under Section 1292 Subd. (a). The court there said at page 185:

“... we should not treat the order as a substitute for a decree in equity enjoining its further prosecution. . . .”

Regarding Lear's attempt to predicate appellate jurisdiction upon Section 1292 Subd. (b), the courts which have considered that section have held that where the District Court fails to identify the allegedly controlling issue of law and fails to explain how its prompt resolution might shorten the litigation, the certification pursuant to that section is defective and will not support an appeal, *In re Heddendorf* (1959, Cir. 1) 263 F. 2d 887, *Milbert v. Bison Laboratories* (1958, Cir. 3) 260 F. 2d 431, *Gotterman v. Central Motors Corporation* (1952, Cir. 2) 268 F. 2d 194, *Speir v. Robert C. Herd & Co.* (1960, D. C. Md.) 189 Fed. Supp. 436.

In its order granting leave to appeal, this court stated that it desired argument on the question of whether “this court may . . . treat the application presented . . . as an application for writ of mandamus.”

Although the Second Circuit has repeatedly held that an appeal from an order which is not appealable cannot be treated as an application for a writ of mandamus, *Zamore v. Goldblatt* (1953, Cir. 2) 201 F. 2d 738, *Magnetic Engineering and Mfg. Co. v. Dings Mfg. Co.* (1949, Cir. 2) 178 F. 2d 866, this court has held that an appeal from a non-appealable order may be considered as a petition for a writ of mandamus, *Shapiro v. Bonanza Hotel Co.* (1950, Cir. 9) 185 F. 2d 777,

*Steccone v. Morse-Starrett Products Co.* (1951, Cir. 9) 191 F. 2d 197. Defendant-appellee John S. Adkins (hereinafter referred to as "Adkins") believes that the rule formulated by this court is correct, and because mandamus is the proper remedy to obtain review of a stay order, *Mach-Tronics, Inc. v. the Hon. Alfonso J. Zirpoli* (1963, Cir. 9) 316 F. 2d 820, *Butler v. Judge of the U. S. District Court, etc.* (1941, Cir. 9) 116 F. 2d 1013, Adkins will proceed without further discussion of the procedural questions to the *sole* issue, which has been stated by the court and accepted by Lear (appellant's concise statement of points on appeal) and Adkins as whether or not the District Court "abused its discretion in granting the said order for stay" (Order, filed April 25, 1963).

## II.

### Statement of the Case.

Appellant's statement of the case (O. B. pp. 2-5) is in part deceptive and misleading and in certain particulars false and untrue, and totally fails to apprise this court concerning the basis of the granting of Adkins' motion for a stay of all further proceedings, and therefore Adkins is required to set forth at some length the facts which are material.

### The Federal Court Action.

The action in the United States District Court for the Southern District of California (hereinafter referred to as the "federal court action") was commenced on March 4, 1963 by the filing of the Complaint for declaratory relief which alleged that Adkins has charged Lear with infringement of United States Letters Patent No. 2,919,586 (hereinafter referred to as



“said patent”) entitled “Gyroscope” [Tr. p. 3, lines 25-28]<sup>2</sup> and which seeks a declaratory judgment that said patent is invalid and/or that gyroscope products manufactured by Lear do not infringe said patent [Tr. p. 9, lines 17-30]. Lear characterizes the federal court action as seeking a declaratory judgment of “invalidity, unenforceability and non-infringement” of said Patent (O. B. p. 2). The Complaint failed to make any mention of either the state court action which had been pending since January 5, 1960 or the patent license agreement dated September 15, 1955 between Adkins and Lear concerning said patent and which is the subject matter of the state court action.

On March 15, 1963, Adkins filed a “Notice of Motion and Motion for Stay of All Further Proceedings” [Tr. pp. 11-13]. This motion was heard on April 1, 1963 and was granted, and the court ordered that the federal court action be stayed until final adjudication of the state court action [Tr. pp. 75-76].

The District Court, as an additional ground for its stay order stated that the federal court action “would not be tried until fall anyway” [Tr. Vol. II p. 3, line

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<sup>2</sup>Although Adkins denies that he has ever charged Lear with infringement of said patent [Tr. p. 17, line 24, to p. 18, line 7] there is not yet any issue in the District Court or before this Court concerning whether or not Adkins has charged Lear with infringement of said patent, the sole issue herein being whether the District Court properly stayed the federal court action pending the outcome of the state court action. It should be noted however that Lear apparently erroneously relies upon the contract controversy in the state court action as constituting an “actual controversy” under the Patent Laws (O. B. p. 8).

6] which according to Adkins' affidavit in support of the motion would be after the trial of the state court action [Tr. p. 18, line 32].

At the time that said stay order was entered no answer had been filed by Adkins in the federal court action.<sup>3</sup>

#### **The State Court Action.**

The state court action was commenced on January 5, 1960 by Adkins [Tr. pp. 20-25] and an answer thereto was filed by Lear on February 10, 1960 [Tr. pp. 44-46]. Attached as Exhibit 2 to the Complaint in the state court action [Tr. pp. 27-43] was a copy of an "Agreement" between Adkins and Lear dated September 15, 1955 (hereinafter referred to as "said agreement") and which is the subject matter of the state court action and which provides insofar as here material that Lear agrees to pay to Adkins a royalty of 1¼% on all gyroscope products manufactured and sold by Lear [Tr. p. 31] which embody a claim or invention disclosed or intended to be disclosed in an application for United States Letters Patent [Ex. B to said agreement] which are "patented or patentable" [Tr. p. 29]. (Said application matured into said patent.) Said agreement further provides in a paragraph entitled "List of Products" that the MA-1 compass (which contains a Model 2156 gyro [Tr. p. 15, lines 26-27]) and the

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<sup>3</sup>Lear's statement of the case at p. 3 states that "no answer to the Complaint" in the state court action has been filed, which is untrue in that Lear answered the Complaint in the state court action on February 10, 1960 and the state court action has been at issue since that date.

Model 2152 and Model 2153 steel gyros are products covered by said agreement. Said agreement also provides in Paragraph 2(a) that Lear shall have the right on 90 days prior written notice to Adkins to terminate any one or more licenses granted in said agreement [Tr. p. 30].<sup>4</sup>

On December 27, 1957 Adkins resigned his position at Lear effective February 1, 1958 and Lear failed to give any notice pursuant to Paragraph 11 of said agreement [Tr. p. 16, lines 14-17] and said patent license thereby became a non-exclusive license six months and fifteen days after February 1, 1958, *i.e.*, on August 16, 1958 [Tr. p. 39].

On April 8, 1959, Lear purported to unilaterally terminate said agreement [Tr. p. 16, lines 8-9] although Lear continued to use the invention covered by said agreement and described in the Application for Letters Patent which was Exhibit B to said agreement [Tr. p. 16, lines 10-13].

These facts were before the trial court in the federal court action and were not denied by Lear.

On January 5, 1960 said Patent issued.

The complaint in the state court action contains two separate causes of action, the first for breach of said agreement, and the second for breach of confidence and misappropriation of plaintiff's "ideas, discoveries and inventions" [Tr. p. 23, line 26, to p. 25, line 1] which also proceeds on implied contract and unjust enrichment theories.

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<sup>4</sup>Although said agreement also concerns another issued Patent and another invention neither is involved in either the federal court action or the state court action.

By motion dated April 11, 1963,<sup>5</sup> Lear sought to limit discovery in the state court action to the period prior to April 8, 1959 arguing that its notice of termination was effective to terminate all contractual obligations of Lear and thereafter Adkins' only course of action was a suit in the federal court for infringement. On May 7, 1963, the court in the state court action rejected this argument stating in part that "*Seagren v. Smith*, 63 Cal. App. 2d 733 is a complete answer to that contention . . . *Seagren v. Smith* is conclusive on this point." In other words the state court has decided that Lears contractual obligation continues over the entire period as to which Adkins makes any claim.

On June 15, 1963,<sup>5</sup> Lear moved in the state court action for leave to file a second amended answer asserting an affirmative defense based on alleged invalidity of said patent on several different grounds. Adkins opposed the filing of this affirmative defense on the theory that Lear was estopped by reason of said agreement to question the validity of said patent. On August 8, 1963<sup>5</sup> the state court based in part on *Bowers Mfg. Co. v. All Steel Equipment, Inc.* (1960, Cir. 9) 275 F. 2d 809, held that Lear was estopped to question the validity of the licensed patent and denied Lear's motion for leave to amend.

Lear urges in this court that the jurisdiction of the federal court on patent questions "is exclusive of the state court" (O. B. pp. 6 and 14). However, in a Memorandum of Points and Authorities filed in the state court action dated August 7, 1963<sup>5</sup> Lear urged

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<sup>5</sup>Adkins request the court to take judicial notice of proceedings in the state court action *Kanouse v. Martin* (1853), 56 U. S. 198.



that the state court has jurisdiction to try the issues of the validity of and the scope of said patent as between the parties since these issues arise collaterally therein, citing *Heins v. Superior Court* (1954) 42 Cal. 2d 164, 266 P. 2d 5, *Rogers v. Hensley* (1961) 194 Cal. App. 2d 486, 14 Cal. Rptr. 870 and 167 A. L. R. 1114.

At the time of the order of the District Court staying all further proceedings, the state court action had been pending for almost *three and one-half years* and a multiplicity of protracted discovery motions and other proceedings had been completed [Tr. pp. 18-19]. On March 15, 1963, plaintiff estimated that the matter would be ready for trial *within* six months [Tr. p. 18, line 32]. On the date hereof substantially all discovery has been completed and the matter is set for pre-trial on October 25, 1963<sup>5</sup> and a trial date is reserved for November 4 or November 11, 1963.<sup>5</sup>

Thus Lear's statement that "the state court proceeding probably will run for several years . . ." (O. B. p. 5) is clearly erroneous and in bad faith.

#### **Summary of Adkins' Argument.**

Adkins' position herein is as follows:

1. That the entire controversy between Adkins and Lear arises out of said agreement and therefore there is no jurisdiction "arising" under the patent laws (28 United States Code, Section 1338 *et seq.*)

2. That in the alternative and because issues concerning the validity and scope of said patent arise collaterally in the state court in a breach of contract action there is concurrent jurisdiction over the questions of the validity of and the scope of said patent in the federal



and state courts rather than exclusive jurisdiction in the federal court. Consequently where there is concurrent jurisdiction there is no federal policy which requires the federal court to proceed where a prior state court action is pending which involves all of the issues in the federal court action and which will be *res judicata* in the federal court action.

3. That the only true basis for federal jurisdiction is the Declaratory Relief Act (28 United States Code, Section 2201) under which the District Court has broad statutory discretion to refuse jurisdiction where a prior state court action will determine all of the issues between the parties in the federal court action and in addition conclude the entire controversy.

### III.

**Where Because of a License Agreement There Is No Federal Jurisdiction Arising Under the Patent Laws or Where There Is Concurrent Jurisdiction of All Issues in Both the Federal and the State Courts, the Federal Court Has Inherent Power to Stay Further Proceedings in the Federal Court Action Pending the Outcome of a Prior State Court Action and It Is Not an Abuse of Discretion to Grant Such a Stay.**

#### **A. The Federal Court Action Does Not "Arise" Under the Patent Laws.**

In *Atlas Imperial Diesel Co. v. Lanova Corp.* (1948 D.C. Del.), 79 F. Supp. 1002, Lanova sued Atlas in the state Superior Court for royalties due under a patent license agreement covering 39 patents. Two weeks thereafter, Atlas, alleging jurisdiction based solely on the federal patent laws, sued Lanova in the federal court for a declaratory judgment seeking, among other things, a declaration that the 39 patents were invalid.

In *dismissing* the federal court action the District Court held relying on *Pratt v. Paris Gas Light & Coke Co.* (1897), 168 U. S. 255 that the entire controversy arose out of the license agreement and therefore there was no federal jurisdiction under the patent laws as the action did not “arise” under the Patent Laws within the meaning of 28 U. S. C. §1338, Subd. (a).

The Court said at page 1004:

“A suit involving a license agreement is not necessarily a suit under the patent laws even if a patent or claims have to be construed. . . .”

Accord, *Luckett v. Delpark* (1926), 270 U. S. 496 where the United States Supreme Court held that an action does not “arise” under the Patent Laws so as to confer federal jurisdiction where issues involving a patent license agreement between the parties are preliminary issues which must be considered before any consideration of the patent issues of validity and scope.

Consequently under the *Lanova* case, *supra*, and the *Luckett* case, *supra*, the existence of said agreement results in the absence of jurisdiction in the federal district court based on the patent laws as the suit does not properly “arise” under the patent laws within the meaning of 28 U. S. C. §1338, Subd. (a).

*Miehle Printing Press & Mfg. Co. v. Publication Corporation* (1948, Cir. 7) 166 F. 2d 615, relied upon by Lear herein (O. B. p. 15) involved a license for an experimental 90 day period at the conclusion of which both plaintiff and defendant *agreed* that defendant had the right to terminate the license agreement. At the time of termination defendant ceased using the licensed invention and did not manufacture a similar device until

four years later. Under these circumstances the court basing its decision upon the absence of any issue concerning defendant's right to cancel the agreement held that defendant was not estopped to question the validity of the patent. The court stated that there was "no question as to the right of the defendant under the agreement to effect such a cancellation."

The case at bar is patently different in that it is uncontroverted that Lear did not cease manufacture of products under the said agreement, and the effectiveness of Lear's purported unilateral cancellation of said agreement is not only one of the main issues in the state court action, and also a question of state law, but is also an issue that has been decided adversely to Lear.

**B. Because of Said Agreement There Is Concurrent Jurisdiction in the Federal Court Action and the State Court Action Concerning the Issues of Validity and Scope of Said Patent.**

Lear predicates its argument in this court on the erroneous proposition that the federal court has exclusive jurisdiction concerning the questions of validity of and the scope of said patent, and then places principal reliance upon *Mach-Tronics, Inc. v. The Hon. Alfonso J. Zirpoli* (1963, Cir. 9), 316 F. 2d 820, which Lear cites for the proposition that the federal court cannot refuse jurisdiction because of the pendency of a prior state court action where the jurisdiction of the federal court is exclusive.

In the instant action because there is no federal jurisdiction based on the patent laws, there is no policy requiring federal determination of substantive federal law questions similar to that in the *Mach-Tronics*

case which requires the federal court to exercise its exclusive jurisdiction over treble damage antitrust suits. Rather, where no substantive federal law over which federal jurisdiction is exclusive is involved the declared federal policy requires the federal court to refuse to exercise its jurisdiction (see *infra*, Point III C). As this court said in the *Mach-Tronics* case *supra* abstention is justified in those cases where

“after certain issues have been determined in the state court it may come about that the decision in the state court may render further action in the federal court unnecessary. . . .”

In addition, the *Mach-Tronics* case *supra*, is entirely distinguishable from the case at bar on other grounds. In the *Mach-Tronics* case, *supra*, the court after reviewing the cases where federal abstention is permissible, held that since jurisdiction of a treble damage suit under the anti-trust laws is exclusive in the federal courts, and since a defense in the state court action based on a violation of the anti-trust laws is not *res judicata* in the federal court treble damage suit, there would be no justification for delaying trial of the treble damage suit pending the outcome of the state action. In reaching this result the court stated that the treble damage suit was a creation of federal statute and relied upon the exclusivity of federal jurisdiction over such an action.

Although the Patent Laws are also a creation of federal statute this is the only similarity. In the case at bar, a decision in the state court action will be *res judicata* on the same issues in the federal court action, *Lyons v. Westinghouse Electric Corporation* (1955, Cir. 2), 222 F. 2d 184, *Atlas Imperial Diesel Co. v. Lanova*



*Corp.* (1948 D.C. Del.), 79 F. Supp. 1002. Furthermore, it has long been held that there is concurrent jurisdiction in federal and state courts over questions of patent validity and scope where those issues arise collaterally in a state court matter, *H. J. Heins Co. v. Owens* (1951, Cir. 9), 189 F. 2d 505, *Seagren v. Smith* (1944), 63 Cal. App. 2d 733, 147 P. 2d 682. In the *Heins* case, *supra*, this court held that the federal court will not interfere with a suit pending in a state court because it collaterally involves patent issues, but will assume that the state court, which has certain power to deal with patent questions will correctly decide those questions.

In short, a treble damage suit under the federal anti-trust laws where jurisdiction is exclusive and where any determination of those issues in a state court when they arise defensively is not *res judicata*, cannot be analogized to a suit involving patent questions where the federal courts have recognized concurrent jurisdiction in the state court and where the result in the state court will be *res judicata* in the federal court action—especially where there is no jurisdiction in the federal court “arising” under the patent laws.

The case at bar is by far more similar to *United States v. Adamant Co.* (1952, Cir. 9), 197 F. 2d 1 where the court pointed out that “both the federal and state courts have jurisdiction” and held that despite the right of the federal court to deal concurrently with certain issues, as a matter of comity, where the state court has first acquired jurisdiction there should be no interference by the federal courts until the state action has been disposed of.



Lastly, as this court said in the *Mach-Tronics* case, *supra*, a federal district court controls its own calendar. As shown by the transcript of the hearing the issuance of the stay order was based in part upon the trial court's recognition that its calendar would not permit trial until the fall of 1963 when the same parties represented by the same attorneys would be *trying* the same issues in the state court action.

Once jurisdiction based on the patent laws is eliminated by the existence of said agreement, this action involves only the application of state law to contract issues.

Unlike the *Mach-Tronics* case where the state court action was filed only two months before the federal action, the instant state court action was filed and became at issue more than three years before Lear filed the federal court action.

In an attempt to avoid the results which follow from concurrent jurisdiction Lear argues in this court that Alkins' only remedy for the period after the purported unilateral termination of said agreement is a suit for infringement in the federal court (O. B. pp. 4-5). Adkins' remedies in the state court action are, of course, questions of state law which should be decided by the state courts. Not only has this precise point been decided by the state courts but it has also been decided in the state court action, the trial court holding that "*Seagren v. Smith*, 63 Cal. App. 2d 733 is a complete answer to that contention . . . *Seagren v. Smith* is conclusive on this point".

In *Seagren v. Smith* (1944), 63 Cal. App. 2d 733, 147 P. 2d 682, it was held that even if a patent license

is, according to provisions therein, terminated by the licensee, if the licensee continues to manufacture products under the license the licensor is not limited to the federal remedy of infringement but can sue on the contract upon the implied obligation to pay royalties upon products manufactured after the purported termination. In other words, a termination which is unaccompanied by a cessation of manufacture of the licensed product is ineffectual to terminate either the licensee's contractual liability or the state courts jurisdiction.

**C. It Is the Policy of the Federal Courts to Decline to Exercise Federal Declaratory Relief Jurisdiction Where All Issues Are Pending in a Prior State Court Action.**

In *Brillhart v. Excess Ins. Co. v. America* (1942), 316 U. S. 491, 63 S. Ct. 1173, the court held that the District Court was not compelled to assume jurisdiction of a declaratory relief suit, but had statutory discretion to stay or dismiss a suit for declaratory relief where the same issues were pending between the same parties in a prior state court action. Accord, *Home Indemnity Company, New York v. Lechner* (1961, S. D. Cal.), 191 F. Supp. 116, where the court also held that the word "may" in the Declaratory Relief Act (28 U. S. C. §2201) was *permissive* and that the federal court could refuse to exercise declaratory relief jurisdiction where plaintiff was using the Declaratory Relief Act in an effort to obtain a piecemeal determination of a prior state court proceeding.

In *Bowers Mfg. Co. v. All Steel Equipment Co.*, (1960, Cir. 9), 275 F. 2d 809, this court held that a nonexclusive licensee cannot unilaterally terminate the license agreement and by that device avoid the doctrine

of estoppel to question the validity of the licensed patent, and also held that a licensee cannot by resort to the federal declaratory relief act avoid that estoppel and said at page 813:

“Appellant has no more right to attack its licensors patent in a declaratory action than by rescission, or in defense of a suit for royalties.”

See also *Yellow Cab Co. v. City of Chicago* (1951, Cir. 7), 186 F. 2d 946, where the court held that the District Court had discretion to refuse declaratory judgment jurisdiction where the result “would not finally determine the rights of the parties” or “where it is being sought merely to determine issues which are involved in a case already pending and can be properly disposed of therein.” The court also said at page 951:

“Nor should declaratory relief be granted where it would result in piecemeal trials of the various controversies presented or in the trial of a particular issue without resolving the entire controversy . . .”

In 6 Moore’s Federal Practice 3153, §57.28, *Pending Actions*, the author states that:

“. . . where as in a declaratory action, the discretion of the federal court to grant relief is invoked, the court may properly refuse to proceed where, because of the duplicating character of the federal action, it does not sufficiently serve a useful purpose . . .”

In *Kcrotest Mfg. Co. v. C-O-Two Fire Equipment Co.* (1952), 342 U. S. 180, 72 S. Ct. 219, the court, in upholding the reversal of the trial court’s denial of a stay of a second action involving only some of the

issues in the prior action pending in another district court quoted, with approval, the following language from the circuit court opinion:

“‘. . . on the other hand if the battle is waged in the Delaware arena there is a strong probability that the Chicago suit nonetheless would have to be proceeded with . . . the Chicago suit when adjudicated will bind all the parties in both cases. *Why under all the circumstances, should there be two litigations where one will suffice. We can find no adequate reason . . .*’” (Emphasis added).

In *CMAX, Inc. v. Hall* (1962, Cir. 9) 300 F. 2d 265 the court in holding that the granting of a continuance of a trial pending the outcome of certain administration proceeding was not an abuse of discretion said at page 268:

“Where it is proposed that a pending proceeding be stayed, the competing interests which will be affected by the granting or refusal to grant a stay must be weighed. Among these competing interests are the possible damage which may result from the granting of a stay, the hardship or inequity which a party may suffer in being required to go forward, and the orderly course of justice measured in terms of the simplifying or complicating of issues, proof, and questions of law which would be expected to result from a stay”.

In *H. J. Heinz Co. v. Owens* (1951, Cir. 9), 189 F. 2d 505, this court, in holding that it would be an abuse of discretion not to stay a federal declaratory relief action instituted after a state court action and



involving only some of the issues pending in the state court action said:

“the wholesome purpose of declaratory acts would be aborted by its use as an instrument of procedural fencing either to secure delay or choose a forum.

\* \* \*

“Other courts have similarly emphasized the perversion of the purpose of declaratory judgment legislation which occurs when it is used to anticipate the result of litigation pending in another forum. . . .”

In the case at bar, assuming *arguendo* that Adkins has charged Lear with infringement, the sole issues are the validity of and the scope of said patent.

Even if these questions are decided by the federal court and before a trial in the state court action and in Lear's favor, this would not bar Adkins from proceeding with the state court action for damages for breach of said agreement, for breach of confidence and misappropriation, for breach of an implied agreement, and for unjust enrichment. For example, the state court could decide under the second cause of action that even if said patent is invalid, or if valid but that Lear's products are not within the scope of said patent, that nevertheless Lear is liable to Adkins on a misappropriation theory, or an implied contract theory, or an unjust enrichment theory. Or if said patent is declared invalid in the federal court action the state court could nevertheless decide under the first cause of action that under said agreement Lear is obligated to pay royalties to Adkins even if said patent is invalid as the contractual test for the payment of royalties under Article



1(d) of said agreement is not validity or invalidity but issuance of a patent by the Patent Office. Other examples of issues present only in the state court action which would be unaffected by a decision in the federal court action are apparent and could easily be set forth.

Although the federal court action cannot be fully determinative, the converse is not true in that the state court action will fully adjudicate all of the issues in the federal court action between the parties since the validity of the patent or estoppel to question its validity, and the scope of said patent are all proper issues in and will be decided in the state court action.

In other words, the trial of the federal court action could under no circumstances determine all the issues between Adkins and Lear, whereas final determination of the state court action will determine all issues between the parties and will decide the entire controversy. Lear's unsupported statement that "most or all of the issues in the present action will not be resolved in the state court action" (O. B. p. 5) is clearly refuted by even a cursory analysis of the issues present in both actions.

It is clear that Lear's sole purpose in instituting this action more than three years after the state court action became at issue, and based upon sham allegations of a charge of infringement, is an attempt to secure an adjudication of the questions of the validity of and the scope of said patent and in the unlikely event that said patent is adjudged invalid or Lear's gyroscope products are held not to be within the scope of said patent to use the federal judgment as a possible defense to the contract action now pending in the state court.

As this court said in *H. J. Heinz Co. v. Owens, supra*:

“ . . . this suit is an effort to interfere directly . . . with state proceedings . . . it is an effort to embarrass the state proceedings or at least to obtain a federal adjudication . . . possibly . . . helpful to the defense in the state . . . proceedings. . . ”

The federal court action is no more than a procedural maneuver which at best interferes with the state court action and which can only result in multiple piecemeal litigation which is both dilatory and vexatious and which should not be permitted.

An additional vice inheres in Lear's attempt to single out for separate trial in a different court the questions of the validity of and the scope of said patent in that when these issues are removed from the context of said agreement the preliminary and decisive issue of estoppel to question the validity of said patent is thereby avoided. A similar attempt to secure such a result was condemned by this court in *Bowers Mfg. Co. v. All Steel Equipment, Inc.* (1960, Cir. 9), 275 F. 2d 809.

Lastly, as a result of the decision in the state court action on August 8, 1963 that Lear is estopped to question the validity of said patent, a decision of invalidity, even if one could be obtained in the federal court action not only would have no effect on the state court action but in addition would have no effect on the controversy between the parties, and would thus serve no useful purpose at all.

IV.

Conclusion.

It is clear that the District Court had the discretion in an action such as this, and which does not involve *exclusive* federal jurisdiction over statutory substantive federal law, to stay the federal court action pending the outcome of the prior state court action.

Under the circumstances it is submitted that the stay granted by the federal trial court, in order to avoid multiple and vexatious litigation instituted for the obvious and apparent purpose of increasing delay and multiplying expense does not constitute an abuse of discretion where the federal court action can only decide a part of the entire cause which has been pending in the state court action for more than three years and which is about to be tried.

If Lear sincerely desires the "prompt adjudication" it asserts is essential (O. B. p. 5) it should proceed to trial in the state court action where every issue between Adkins and Lear can and will be decided.

Respectfully submitted,

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### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

PETER COHEN





No. 18634

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

LEAR SIEGLER, INC., a corporation,

*Appellant,*

*vs.*

JOHN S. ADKINS,

*Appellee.*

---

## APPELLANT'S REPLY BRIEF.

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No. 18634

IN THE

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---

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*Appellant,*

*vs.*

JOHN S. ADKINS,

*Appellee.*

---

## APPELLANT'S REPLY BRIEF.

---

### I.

#### Summary of Appellee's Arguments.

Appellee's brief asserts many factual matters concerning a state court action that are not part of the record in this case.

Appellee asserts that this Court may treat appellant's application as an application for a writ of mandamus to ascertain whether or not the District Court abused its discretion in granting a stay of all further proceedings until final adjudication of an action pending between the same parties in the state court. However, Appellee asserts that this Court does not have appellate jurisdiction under 28 U.S.C. §1292.

Appellee also asserts that the federal court action does not arise under the patent laws because of a license agreement.

Appellee further asserts that there is concurrent jurisdiction of all issues in both the federal and state courts and that the federal court should stay further proceedings pending the outcome of the state court action.

These assertions will be discussed in the order set forth above.

## II.

### **The Proceedings in This Appeal Must Be Based Upon the Record Which Was Before the District Court.**

The question before this Court on appeal is whether or not the District Court erred or abused its discretion in granting the stay which was entered on April 9, 1963.

In his statement of the state court action and in various arguments, Appellee has asserted many matters which are not part of the record which was before the District Court, and many of which occurred after April 9, 1963. If such matters are to be considered on this appeal, it is submitted that these matters should be made part of the record. If this is done, the record will show that many of the Appellee's assertions as to the proceedings before the state court are not correct.

Appellee asserts that this Court may take judicial notice of the proceedings in the state court action, citing *Kanouse v. Martin* (1853), 56 U.S. 198. The *Kanouse* case involved the inspection of proceedings which showed the judgment of a state court to be erroneous. It is submitted that it is not proper to ask this Court to take judicial notice of proceedings in a state court which are continuing and becoming more and more

involved every week and in which there has been no trial or judgment. The proceedings that were part of the record before the District Court as of April 9, 1963 are the only proceedings in the state court that are part of the record of this case.

Rule 75 of the *Federal Rules of Civil Procedure* sets forth what shall comprise the record before the Court of Appeal. This rule went into effect in 1948, long after the decision in the *Kanouse* case in 1853, which is relied upon by the Appellee. In addition, the rules of the United States Court of Appeals for the Ninth Circuit provide in Rule 10 that “All appeals, civil and criminal, shall be heard on the original papers and the reporter’s transcript of evidence or proceedings, as designated and transmitted to this court in the manner provided in Rule 75(o), Federal Rules of Civil Procedure. . . .”

This Court has previously stated:

“Matters which were not before the trial court will be stricken on motion, even if they have been included in the record on appeal by stipulation. *Heath v. Helmick*, 9 Cir. 173 F.2d 156.” *Panaview Door & Window Co. v. Reynolds Metals Company* (9th Cir. 1958), 255 F.2d 920.

Information not a part of the record should have no place in the briefs of either party. *United States v. State of Arizona et al.* (9th Cir. 1954), 214 F.2d 389.

Accordingly, Appellant will not comment further upon such information.



III.

**This Court Has Appellate Jurisdiction Under 28 U.S.C. 1292(b) as Well as Under 28 U.S.C. 1651.**

In its order in response to Appellant's application for leave to take this appeal, this Court stated:

"The controlling question of law, if any, is and must be whether the district court erred or abused its discretion in granting said stay through its said order relating to stay of all further proceedings.

"This court is of the opinion that the application for leave to take an appeal from the interlocutory order aforesaid should be granted for the purpose of permitting argument before this court and review of the following questions:

"1. Whether an order for a stay is the type or kind of an order which could or does involve a controlling question of law within the meaning of § 1292(b) of Title 28 U.S.C.?

"2. Whether in case said question No. 1 is answered in the affirmative, the district court was in error or abused its discretion in granting the said order for stay?

"3. Whether in case it be determined that this appeal could not properly be maintained because of a negative answer to the first question above stated, this court may nevertheless consider and treat the application presented to us as an application for writ of mandamus. Cf. *Mach-Tronics*, No. 18340 (April 1, 1963)."

Appellee agrees that Appellant's application may be treated as an application for writ of mandamus and directs his arguments to whether or not the District Court abused its discretion.

Appellant asserts that the order for the stay involves a controlling question of law within the meaning of 28 U.S.C. 1292 (b) and that the stay ordered by the District Court was in error as presented in questions Nos. 1 and 2 suggested for review by this Court, as well as constituting an abuse of discretion as presented in question No. 3 suggested for review by this Court.

The complaint in the action before the District Court seeks a Declaratory Judgment of invalidity, unenforceability, and non-infringement of United States Letters Patent No. 2,919,586. [Tr. 2-9]. This sets forth a case arising directly under the patent laws. The District Court has original jurisdiction under patent cases to the exclusion of state courts. 35 U.S.C. 1338 (a).

The state court action is based on breach of contract and misappropriation [Tr. 20-25]. In the state court action, the Court may incidentally determine some of the issues which are involved in the present appeal, i.e., validity, infringement and enforceability of the patent. Such an incidental determination of validity, infringement and enforceability of the patent in question is not conclusive in a subsequent action brought to determine the matter directly. *Restatement of the Law of Judgments*, § 71. *Lyons v. Westinghouse Electric Corporation* (2nd Cir. 1955), 222 F.2d 184.

Moreover, a stay which is to be effective until final adjudication of the state court action may create a situation in which a state court judgment may be rendered as to certain matters which is not in accord with a

subsequent judgment of the federal court which has exclusive jurisdiction over such matters. Since Congress has entrusted to the federal courts original and exclusive jurisdiction over actions arising under any Act of Congress relating to patents, a stay of such an action in the federal court pending the outcome of an incidental determination of such issues in a state court is not proper because a conflict between the state and federal court decisions may result. *Propper v. Clark* (1948), 337 U.S. 472. *Mach-Tronics, Incorporated v. The Honorable Alfonso J. Zirpoli* (9th Cir. 1963), 316 F.2d 820.

Thus, the controlling question of law is whether the District Court erred or abused its discretion in staying all the further proceedings in a case arising directly under the patent laws pending final adjudication of a state court action in which some of the issues in the present case may be decided incidentally or collaterally to the causes of action set forth in the state court action.

This controlling question of law is presented in the Transcript of Record [Tr. 2-25] before this Court, and the District Court in its order stated that:

“The Court finds that this Order involves a controlling question of law as to which there is ground for difference of opinion and that an immediate appeal from this order may materially advance the ultimate termination of this litigation.”  
[Tr. 88-89]

It is submitted that the Transcript of Record and the order of the District Court satisfy the jurisdictional requirements of 28 U.S.C. 1292 (b) for an appeal to this Court.

Appellee states that it is necessary for the District Court to identify the particular issue of law and explain how its prompt resolution might shorten the litigation. The cases cited by the Appellee do not substantiate this assertion. *In re Heddendorf* (1st Cir. 1959), 263 F.2d 887 is a case in which the court was undecided as to whether the District Court decision was an interlocutory decision under 28 U.S.C. 1292 or a final decision under 28 U.S.C. 1291, and the court decided not to permit an interlocutory appeal. In *Milbert v. Bison Laboratories* (3rd Cir. 1958), 260 F.2d 431, the order of the District Court did not contain a statement to the effect that the order involved a controlling question of law so as to permit immediate appeal, and in *Speir v. Robert C. Herd & Co.* (D.C. Md. 1960), 189 Fed. Supp. 436, the District Court expressly refused to include such a statement in its order. In *Gottcsman v. General Motors Corporation* (2nd Cir. 1952), 268 F. 2d 194, the court held that an immediate appeal would not materially advance termination of the litigation because the matter in dispute merely related to a pre-trial ruling.

Thus, none of the cases cited by Appellee support his contention that the District Court must identify the particular issue of law and explain how its prompt resolution might shorten the litigation.

As discussed above, the Transcript of Record shows that there is a question of law as to whether or not it is proper for a District Court to stay proceedings in a case brought directly to determine matters over which it has original and exclusive jurisdiction until final adjudication of a case in the state court in which such matters may be incidentally determined.



Likewise, the record shows that a prompt resolution of this question of law may materially advance the ultimate termination of this litigation. The state court proceedings were instituted in 1960 [Tr. 14] and have not gone to trial yet. Appellate proceedings may delay the final resolution of the state court proceedings for years [Tr. 85]. Even then, the issues over which the District Court has original and exclusive jurisdiction can not be resolved because any final adjudication of such issues in the state court will not be controlling or conclusive in the present action before the District Court. *Restatement of the Law of Judgments*, Sec. 71. *Lyons v. Westinghouse Electric Corporation* (2nd Cir. 1955), 222 F.2d 184.

Moreover, Appellee asserts that he will seek to enforce the patent in question against Appellant if his state court action is unsuccessful [Tr. 18]. Thus, after litigation in the state court which may run for years in the future, Appellee asserts that he will seek to enforce his patent against Appellant if the state court action is unsuccessful. Moreover, the issues concerning the patent in suit may not be involved in any judgment which the state court may render. For example, the state court decision could be based upon the misappropriation issue alone without considering the patent in suit at all. A prompt resolution of the issues of patent infringement, validity and enforceability will materially advance the ultimate termination of this controversy.

It is submitted that all of the requirements of 28 U.S.C. 1292 (b) are met.

As set forth in detail in Appellant's Opening Brief, all of the requirements of 28 U.S.C. 1651 concerning writs of mandate are met.



Accordingly, it is submitted that this Court has appellate jurisdiction under both of the above statutory provisions.

#### IV.

### **The Present Cause of Action Arises Under the Patent Laws and the District Court Has Exclusive Jurisdiction Over Patent Cases to the Exclusion of State Courts.**

Appellee asserts that the present action does not arise under the patent laws.

28 U.S.C. 1338 (a) states:

“The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents, copyrights and trademarks. Such jurisdiction shall be exclusive of the courts of the states in patent and copyright cases.”

Whether or not the present case arises under the patent laws depends on the nature of the cause of action as set forth in the pleadings. *Henry Pratt v. Paris Gaslight & Coke Company* (1897), 168 U.S. 458. The cause of action as set forth in Appellant’s pleadings is for Declaratory Judgment of invalidity, unenforceability, and non-infringement of United States Letters Patent No. 2,919,586 [Tr. 2-10]. These issues arise under and are controlled by Acts of Congress. The acts are set forth in 28 U.S.C. 1338 (a) concerning jurisdiction, 28 U.S.C. 2201 concerning declaratory judgments, 35 U.S.C. 100-188 concerning the validity of patents, 35 U.S.C. 271-392 concerning infringement of patents, and in various provisions of 35 U.S.C. and 15 U.S.C. 1-15 concerning enforcement of patents.

A state court may determine validity, infringement, and enforceability of a patent when such issues arise

incidentally to a cause of action in a case over which the state court has direct jurisdiction. *H. J. Heins Co. v. Superior Court* (1954), 42 Cal. 2d 164. *Rogers v. Hensley* (1961), 194 Cal. App. 2d 486. However, a state court holding on such issues over which the Federal District Court has original and exclusive jurisdiction is not binding on the Federal District Court in an action brought to determine these patent issues directly. *Restatement of the Law of Judgments*, § 71. Comment "c" under this Restatement section states:

"c. State and federal courts. The rule stated in this Section is applicable where a State court has incidentally determined a matter which the federal courts alone have jurisdiction to determine directly.

"If an action is brought in a State court on a promissory note, and the defendant in his answer alleges that the note was given for a void patent, the decision of the court that the patent was or was not void is not binding in a subsequent action brought in a federal court to have the patent declared void, or to enjoin an infringement of the patent, although the subsequent action is between the same parties, since the federal courts have exclusive jurisdiction to set aside a patent or to entertain a suit for its infringement."

To the same effect are the following cases involving Acts of Congress other than the patent laws in which Congress has given the federal courts exclusive jurisdiction: *Mach-Tronics, Inc. v. The Hon. Alfonso J. Zirpoli*, *supra*; *Lyons v. Westinghouse Electric Corporation*, *supra*; and *Propper v. Clark*, *supra*.

Any incidental determination of the patent issues in the state court action would not be binding in the present action brought to determine the patent issues directly. Accordingly, it is not proper for the District Court to stay its proceedings until final adjudication of the state court action. Any such stay will delay the ultimate determination of whether or not Appellant has any liability under the patent.

V.

**Appellant Is Not Estopped to Contest the Validity of the Patent.**

Appellee asserts that because of a license agreement between the parties there is no federal jurisdiction arising under the patent laws.

The license agreement in question was executed by the parties in 1955 [Tr. 27-43]. The license agreement provided that "Lear shall have the right on 90 days' prior written notice to Adkins, to terminate any one or more of the licenses herein granted." [Tr. 30]. The license agreement also provided that Lear at its option shall have the right forthwith to terminate the entire agreement in the event the U. S. Patent Office refuses to issue a patent on the substantial claims of the application of Exhibit B, which application became the patent which is the subject of the present suit.

Appellant terminated the license agreement exactly in accordance with these provisions of the agreement by a written notice dated April 8, 1959 [Tr. 66]. The patent issued on January 5, 1960 [Tr. 59].

When the license agreement was executed by the parties on September 15, 1955, Exhibit B to the agreement was an application for a patent which had been

filed on February 15, 1954 [Tr. 28] and no claims had been allowed in the application at the time the agreement was executed [Tr. 59]. Claims of a markedly different type appeared in the patent in suit which is based upon Exhibit B to the agreement [Tr. 60-61].

Thus, Appellant never operated as a licensee under any allowed claims in the application for the patent in suit, Appellant never operated as a licensee under any of the claims in the application as originally filed because these claims were not allowed, Appellant never received any benefit from the license agreement, and Appellant terminated the agreement in accordance with its express provisions approximately nine months before the patent issued so that Appellant was never a licensee under the patent. Hence, there can be no estoppel to contest the patent because of the license agreement. Likewise, the terminated license agreement can not affect the jurisdiction of the District Court in a case arising directly under the patent laws.

By the termination, Appellant assumed a legal status of a former licensee, which new status removes all estoppel against Appellant with regard to contesting the validity of the patent. Accordingly, the license agreement has been terminated and it can have no effect on federal jurisdiction arising under the patent laws in an action to contest the patent. In other words, there can be no estoppel of any kind to a former licensee.

In *Miehle Printing Press & Mfg. Co. v. Publication Corporation* (7th Cir. 1948), 166 F.2d 615, the court considered whether or not an exclusive licensee under an application for a patent was estopped to contest the patent when it issued after the license had been terminated. The licensor contended that the licensee used



the process and the teachings of the claims which were the subject of the license, and the licensor also contended that the licensee was estopped to contest the validity of the patent because of the previous license agreement. These are the same contentions that Appellee is making in the present action.

In the *Miehle* case, the court held that the licensee was not estopped to contest the patent because there had been a valid cancellation of the license agreement. The court also held that there was no implied estoppel under such circumstances, stating:

“Moreover, it has been held that an estoppel will not be implied or inferred but that it must clearly appear from the language which the parties have employed.” 166 F.2d 615, 618.

When a licensee is given the right to terminate the agreement by giving notice within a specified time period in writing to the licensor of his indication to terminate the agreement and such notice is properly given, the agreement thereafter lawfully terminates. Such a termination leaves the licensee with the same rights a stranger would have to dispute the title or right of the former licensor. After the termination of the license, the parties are freed from any estoppel resting upon them while in their former relationship. The licensee may dispute the right of title to the former licensor to the same extent as a stranger might. *Stimpson Computing Scale v. W. F. Stimpson et al.* (6th Cir. 1900), 104 F. 893.



The same rule mentioned above has been applied in many Circuit and District Courts, as follows:

CIRCUIT COURT CASES:

- International Burr Corp. v. Wood Grinding Service* (2nd Cir. 1929), 34 F.2d 905;  
*Measurements Corp. v. Ferris Instrument Corp.* (3rd Cir. 1947), 159 F.2d 590;  
*Tate v. Baltimore & Ohio Railway Co.* (4th Cir. 1915), 229 F. 141;  
*Davis v. Buck-Jackson Corporation* (4th Cir. 1956), 230 F.2d 655;  
*H. Tibbe & Son Manufacturing Co. v. Heincken* (C.C.S.D. N.Y. 1889), 37 F. 686;  
*Stimpson Computing Scale v. W. F. Stimpson et al.* (6th Cir. 1900), *supra*;  
*Miehle Printing Press & Mfg. Co. v. Publication Corporation* (7th Cir. 1948), *supra*.

DISTRICT COURT CASES:

- Bituminous Products Co. v. Headley Good Roads Co.* (D.C. Del. 1924), 2 F.2d 83;  
*Frost Ry. Supply Co. v. T. H. Symington & Son* (D.C. Md. 1938), 24 F.Supp. 20;  
*Eskimo Pie Corporation v. National Ice Cream Co.* (D.C.W.D. Ky. 1927), 20 F.2d 1003;  
*DeCew v. Union Bag & Paper Corp.* (D.C. N.J. 1944), 57 F.Supp. 388;  
*Chance v. Lehigh Navigation Coal Company* (D.C.E.D. Pa. 1938), 25 F.Supp. 532;  
*Howe v. Atwood* (D.C.E.D. Mich. 1942), 47 F. Supp. 979.

Appellee asserts that *Atlas Imperial Diesel Engine Co. v. Lanova Corp.* (D.C. Del. 1948), 79 F.Supp. 1002, is authority for the proposition that because of the previous license agreement between the parties hereto, there is no federal jurisdiction in the present action. However, the complaint in the *Atlas* case sought an adjudication of an existing license agreement and of the patents set forth in the license agreement. Thus, the *Atlas* case was not a case arising under the patent laws, but rather was a case arising under the laws concerning contracts.

The present action is one arising under the patent laws. The terminated license agreement between the parties does not change the nature of the action.

Appellee asserts that *Bowers Manufacturing Co., Inc. v. All-Steel Equipment, Inc.* (9th Cir. 1960), 275 F.2d 809, is authority for the proposition that because of the previous license agreement, Appellant is estopped to contest the validity of the patent in suit.

The *Bowers* case involved a nonexclusive license concerning a patent which had already issued. The license was entered into to avoid an infringement suit by the patent owner after exchange of correspondence concerning infringement of the patent. The license agreement had certain cancellation provisions. The licensee did not terminate the license in accordance with the provisions of the agreement. The licensee repudiated the agreement on the basis of failure of consideration. The court pointed out that the consideration for the nonexclusive license was essentially a shield from suit for infringement by the grantor, and hence the invalidity of the patent would not constitute failure of consideration for such a license. The court went on to

point out that the consideration for an exclusive license is the monopoly value of the patent, and hence invalidity of the patent would constitute failure of consideration for such a license.

In the *Bowers* case the court held that the license agreement had not been terminated in accordance with its provisions, but rather had been repudiated by the licensee on the basis of failure of consideration. The court also held that invalidity of the issued patent which was the subject of the nonexclusive license could not constitute failure of consideration because the consideration was essentially abstention from suit for infringement by the patent owner. Accordingly, the court held that the nonexclusive licensee under such circumstances should not be allowed to contest the patent.

In the present case the license agreement was terminated in accordance with the express provisions of the agreement. The consideration for the license agreement was "an exclusive license under all the claims of said Exhibits B" [Tr. 30], which Exhibit B is the application for the patent in suit. This agreement was subject to certain conditions subsequent whereby the license could become nonexclusive [Tr. 39-40].

The original consideration at the time of entering into the agreement of the present action was an exclusive license under the claims of an application for a patent. The claims in the application at the time of execution of the license agreement were never allowed and claims of a markedly different type are in the issued patent [Tr. 59-61]. Appellant terminated the agreement in accordance with its express provisions before the patent issued [Tr. 66].

Thus, the *Bowers* case does not apply to the facts of the present case. There was an issued patent in the *Bowers* case, whereas in the present case there was merely an application for a patent with no allowed claims. The consideration in the *Bowers* case was a nonexclusive license entered into in order to avoid an infringement suit by the patent owner, whereas in the present case the original consideration was an exclusive license which could become nonexclusive upon the occurrence of certain conditions. In the *Bowers* case the main consideration was the settling or compromising of threatened litigation, whereas in the present case the main consideration was an exclusive license which could later become nonexclusive. In the *Bowers* case the monopoly value of the patent was of no consequence to the licensee, whereas in the present case the monopoly value was a primary part of the consideration. In the *Bowers* case the licensee did not terminate the license agreement in accordance with the provisions of the agreement, but rather the licensee repudiated the agreement, whereas in the present case Appellant terminated the agreement in accordance with its provisions.

Accordingly, the doctrine of estoppel set forth in the *Bowers* case has no application to the facts of the present case.

The California case of *Del Riccio v. Photochart* (1954), 124 Cal. App. 2d 301 is to the same effect as the *Bowers* case. In the *Del Riccio* case the license agreement concerning the particular patent in issue was entered into in order to compromise existing litigation between the parties. The court held that the non-exclusive licensee could not contest the licensed patent



because the consideration for the agreement was primarily the compromise of previously existing litigation between the parties concerning the patent.

It should be noted that the California case of *The Armstrong Company v. Shell Company of California* (1929), 98 Cal. App. 769, was not noted in the *Bowers* decision. The *Armstrong* case includes an extensive review of the cases dealing with the doctrine of repudiation and arrives at a result contrary to that reached in the *Bowers* case because of a difference in the consideration for the license agreement. The *Armstrong* case held that after a repudiation of the license agreement, the nonexclusive licensee was not estopped to contest the validity of the patent which was the subject of the license because a license under a valid patent was the main consideration. The court noted that the license agreement did not contain any recital admitting the validity of the patent, but rather it contained a guaranty of validity by the patent owner. The court held that the licensee simply did not receive the only substantial thing for which it bargained because the patent was not valid, and held that the nonexclusive licensee was not estopped to contest the validity of the patent.

In the present case, there is no recital admitting the validity of the patent in suit or admitting the validity of any of the claims which were presented in the application. In the present case, there is a representation and warranty by the licensor concerning validity. The license agreement states that "Adkins represents and warrants that to the best of his knowledge and belief he is the owner of the inventions covering the substantial claims as disclosed or intended to be disclosed in



the application for U. S. Patent for gyroscopes attached hereto and hereafter referred to as Exhibit B" [Tr. 27].

In the present case, Appellant asserts that it did not receive the only substantial thing for which it bargained because none of the substantial claims of the patent application had been allowed at the time the license agreement was terminated. Appellant also asserts that the patent which ultimately issued contains none of the substantial claims and is invalid, and hence appellant could never have received anything substantial even if the agreement had not been terminated.

Thus, the factual situation of the present case with reference to the consideration for the agreement is very similar to that in the *Armstrong* case. In addition, the present case involves an exclusive license as the original consideration rather than a nonexclusive license as was involved in the *Bowers* case.

## VI

### **Any Incidental Jurisdiction Which the State Court Has Over the Issues Concerning the Patent in Suit Is Secondary to the Original and Exclusive Jurisdiction of the District Court.**

Appellee asserts that because of the previous license agreement there is concurrent jurisdiction in the federal and the state courts concerning the issues of validity and scope of the patent, and that the state court should decide these issues.

As discussed above, any jurisdiction which the state court may have concerning validity, infringement and enforceability of the patent is incidental, and the original and exclusive jurisdiction to finally resolve these

issues is in the Federal District Court by Act of Congress.

In *Lionel Corporation et al. v. De Filippis, et al* (D.C. N.Y. 1935), 11 F. Supp. 712, the licensor granted an exclusive license and there was a dispute as to whether or not the license agreement had been terminated. The licensee brought a declaratory judgment action to have the patent adjudicated invalid, or if valid not infringed. The licensor contended that there was an action pending in the state courts which raised substantially all of the issues raised by the Declaratory Judgment action and that the licensee was estopped from contesting the validity or infringement of the patent. However, the court refused to dismiss the complaint on the basis of the pending state court action or on the basis of estoppel on the part of the licensee. The court stated:

“But whether the agreement was terminated as plaintiffs contend, or is in effect as defendants urge, the plaintiffs are not estopped from raising the issue of infringement. The real controversy between the parties is whether the toy boats are an infringement. That cannot be determined except under the patent laws. The issue is one which should be determined in the first instance by a Federal District Court.” 11 F. Supp. 712, 716.

This reasoning is in line with the reasoning of the Supreme Court as noted in the quiet title case of *Lowry et al v. Hert* (6th Cir. 1923), 290 F. 876. The Court at page 878 listed the authorities for federal court jurisdiction of infringement actions beginning with:

“. . . the line of cases of which *Healy v. Seagull Co.*, 237 U.S. 479, 35 Sup. Ct. 658, 59 L.Ed.

1056, is the latest in the Supreme Court, and the *Excelsior Co. v. Pacific Co.*, 185 U.S. 282, 22 Sup. Ct. 681, 46 L.Ed. 910, and *Henry v. Dick Co.*, 224 U.S. 1, 32 Sup. Ct. 364, 56 L.Ed. 645, Ann. Cas. 1913D, 880 (overruled but not on this point), are earlier examples in the same court . . . They establish that where the suit is clearly and plainly one brought for infringement of patent, and involving the issues usual in such cases, the fact is not fatal, whether it appears by the bill or by the answer, that the defendant has had a license under the patent, and that the matter of actual dispute between the parties is whether that license, according to its terms, is still in force. In these cases, it has been considered that the main and primary question is one of infringement, and that the question whether there is a license continuing in force must be taken as a secondary and collateral dispute, however controlling it may turn out to be.”

This same ruling on similar facts is found in the case of *Chicago Metallic Mfg. Co. v. Edward Katzinger Co.* (7th Cir. 1941), 123 F.2d 518, in which the District Court had dismissed a suit for a declaratory judgment upon defendants’ filing of an affidavit which set out the pendency of a state court proceeding involving royalties allegedly due the licensor for articles manufactured under a license. The Circuit Court ruled that although the granting of the remedy of a declaratory judgment is discretionary, the mere pendency of a state court suit between the parties is not basis for refusing a declaratory judgment action. The determining factor noted by the Circuit Court was whether or

not the issues in the action in the District Court and the state court were the same. In this regard, the Court held at page 520:

“ . . . The principal question presented by the complaint in this case is the validity of the patents. That question could not be litigated in the state court case, consequently, the parties are not able to procure a full and immediate adjudication of their rights.”

Even if a state court judgment were in existence today, that judgment would not provide a full and immediate adjudication of the rights of the parties to this suit. Such a state court judgment would not be conclusive or controlling in this action brought directly to adjudicate the invalidity, non-infringement and unenforceability of a patent. Moreover, Appellee, at page 18 of his brief, asserts that the state court could rule in his favor on either cause of action whether the patent is valid or invalid. Thus, the validity of the patent could be moot in the state action since it can be decided without reference to this point. On the other hand if the state court action is unsuccessful for Appellee, he has threatened an infringement suit in the federal courts [Tr. 18]. Of course, it is equally plain that a state court judgment could be framed in such a manner that even if Appellee were successful in the state court, Appellee could bring an infringement suit in a federal court. It is in just such a situation that the Declaratory Judgment act demonstrates its usefulness by affording a prompt adjudication of the rights of parties which must otherwise await long delays in a state court action which cannot properly adjudicate rights arising under the patent laws.



In *H. J. Heinz Co. v. Owens* (9th Cir. 1951), 189 F.2d 505 cited by Appellee, a state court had rendered a judgment and issued an injunction. A contempt action was brought in the state court action, and thereafter the defendant sought, by a declaratory judgment action, an injunction in the federal court to restrain the contempt proceedings in the state court. Thus, in the *Heinz* case the action was to enjoin the enforcement of the decision of a state court and of course that was not an action arising under the patent laws, as in the present case.

Appellee cites *Seagren v. Smith* (1944), 63 Cal. App. 2d 733 in support of his contention that there is concurrent jurisdiction in the federal and the state courts. The *Seagren* case involved the assignment of an issued patent and a license giving the right to make, use and sell certain devices including any improvements made thereafter by the licensor. The licensee reassigned to the original owner all of the rights theretofore assigned and cancelled the agreement. However, he continued to manufacture and sell the devices which were the subject of the license agreement. Under the facts of the *Seagren* case the court held that the licensee was obligated to pay royalties upon the theory of implied contract.

Thus, in the *Seagren* case the question was whether or not the state court had jurisdiction over an action based upon an implied contract. The validity, infringement or enforcement of the patent were not made issues in the state court action and they were not placed directly in issue in a declaratory judgment action, as in the present case.



In *United States v. Adamant Co.* (9th Cir. 1952), 197 F.2d 1, relied upon by Appellee, there was concurrent jurisdiction but the case was not one in which the federal court had original and exclusive jurisdiction, as in the present case.

Moreover, the California courts have fully recognized the distinction between concurrent jurisdiction in some situations, and cases of infringement in which the exclusive jurisdiction rests in the federal court. The case of *Shores v. Chip Steak Co.* (1955), 130 Cal. App. 2d 620 recognized this distinction as defined in 28 U.S.C. § 1338 (a) at page 625.

“The complaint at bar challenges defendants’ claims of valid trademark and valid United States patent. If this were an action for infringement of patent, the federal courts would have exclusive jurisdiction (21 C.J.S. p. 794 § 525; 40 Am. Jur. p. 652, § 169). And plaintiff’s election to sue for declaratory judgment that he is not an infringer does not give the state court power to hear the case; the controversy remains one of exclusive federal jurisdiction. (*E. Edelmann & Co. v. Triple-A Specialty Co.*, 88 F.2d 852; *Grip Nut Co. v. Sharp*, 124 F.2d 814; *Lionel Corp. v. De Filippis*, 11 F. Supp. 712, 716; *Cheatham Elec. Switching Device Co. v. Kentucky S. & S. Co.*, 213 Ky. 23 [280 S.W. 469, 471].) The question of patent infringement cannot be litigated by either party in the state court. . . . The same would be true of copyright infringement if it were directly presented. (*Loew’s, Inc. v. Superior Court*, 18 Cal. 2d 419, 427 [115 P.2d 983].)

“But a different situation exists in relation to federal trademarks. The state courts have concurrent jurisdiction of such infringement cases.”

A patent infringement question, as distinguished from a trademark infringement question, is involved in the present suit. This patent infringement question is one for the exclusive jurisdiction of the federal courts. Since it cannot be conclusively litigated in the state court, it of necessity cannot create a collateral estoppel.

In the *Lyons* case, *supra*, Judge Hand explained why a state court ruling on an issue within exclusive federal jurisdiction cannot create a collateral estoppel in a federal court. It was noted, writing in connection with the exercise of exclusive jurisdiction, that:

“It should be taken to imply an immunity of their decisions of any prejudgment elsewhere, . . .”  
222 F.2d 184, at 189.

In *Mach-Tronics, Incorporated v. The Honorable Alfonso J. Zirpoli*, *supra*, this Court stated:

“It has long been recognized that when a federal court is properly appealed to in a case over which it has by law jurisdiction, it is its duty to take such jurisdiction.” 316 F.2d 820, 828.

This Court went on to consider the cases in which abstention is justified because of a pending state court action and concluded that abstention is not justified when the administration or enforcement of an Act of Congress is involved. This Court stated with reference to the anti-trust laws:

“We think that here in any event the federal court must sooner or later determine the issues presented by the treble damage complaint.” 316 F.2d 820, 830.

\* \* \* \* \*

“ . . . the court cannot avoid a decision of that issue no matter what the state court decision may turn out to be.” 316 F.2d 820, 831.

With reference to abstention on the basis of concurrent jurisdiction and the possibility that it might be an estoppel, this Court stated:

“But let us suppose that such a determination in a state court would operate as an estoppel. That in our view would constitute an additional reason for the respondent court to proceed without delay. . . .” 316 F.2d 820, 832.

The patent laws are Acts of Congress, and the comments of this Court in the *Mach-Tronics* case concerning other Acts of Congress apply equally to the present case.

### Conclusion.

This Court has jurisdiction over this application under 28 U.S.C. 1292, as well as under 28 U.S.C. 1651.

The previous license agreement between the parties does not affect federal jurisdiction in this action which arises under the patent laws.

The terminated license agreement between the parties under Appellee's application for a patent does not estop Appellant from contesting the patent which ultimately issued after termination of the license agreement.

The federal court has original and exclusive jurisdiction over the present cause of action which is brought to determine the issues of validity, infringement and enforceability of a patent. Any jurisdiction which the state court has over such issues is incidental, and any decision by the state court on these issues will not be binding upon the federal court.

It is requested that this Court promptly direct the District Court to remove the stay of all further proceedings, and that this Court direct the District Court to proceed without delay to adjudicate the issues which have been entrusted to its original and exclusive jurisdiction by Acts of Congress.

Respectfully submitted,

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### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

C. RUSSELL HALE



**United States Court of Appeals**  
**FOR THE NINTH CIRCUIT**

No. 18635

ALBERT AGOBIAN and  
ALBERT EGISHIAN,

Appellants,

vs.

UNITED STATES OF AMERICA,

Respondent.

Appeal from the United States District Court  
Southern District of California  
Southern Division

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APPELLANT'S OPENING BRIEF

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IN THE  
UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

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ALBERT AGOBIAN and  
ALBERT EGISHIAN,

Appellants,

vs.

UNITED STATES OF AMERICA,

Respondent.

---

APPELLANT'S OPENING BRIEF

---

I.

STATEMENT OF JURISDICTION

This is an appeal from a judgment of the United States District Court for the Southern District of California, Southern Division, adjudging both appellants guilty of a one-count indictment charging a violation of Title 21, United States Code, Section 174, to-wit, concealment and transportation of illegally imported narcotics. A one-count Indictment was returned by the Federal Grand Jury for the Central Division of the Southern District of California and said Indictment was filed on April 18, 1962 (C.T. 2). Thereafter, on motion by both appellants the cause was transferred pursuant to Rule 19 of the Federal Rules of Criminal Procedure

(18 U.S.C.) to the Southern Division of the Southern District of California (C.T. 7 and 8). Both appellants were convicted after jury trial and judgment entered and sentence imposed on each appellant on October 5, 1962 (C.T. 28 and 29). Both appellants thereafter filed a timely notice of appeal (C.T. 30 and 31).

The District Court had jurisdiction pursuant to the provisions of Title 18, United States Code, Section 3231. This Court has jurisdiction to entertain the instant appeal from the judgment under Sections 1291 and 1294 of Title 28, United States Code and Rules 37 and 39 of the Federal Rules of Criminal Procedure (Title 18, U.S.C.)

## II.

### STATEMENT OF THE CASE

The Indictment returned against appellants by the Grand Jury for the Central Division of the Southern District of California, United States District Court, and filed April 18, 1962, alleged:

"On or about March 28, 1962, in Los Angeles County, California, within the Central Division of the Southern District of California, defendants Albert Agobian and Albert Egishian, knowingly and unlawfully received, concealed and facilitated the concealment and transportation of one gram, 370 milligrams of heroin, a narcotic drug, which as the defendants then and there well knew, previously had been imported into the United States of America contrary to the United States Code, Title 21, Section 173."

(C. T. 2)



Subsequent to the return of the Indictment, on motion made by each appellant the cause was transferred for all further proceedings to the Southern Division of California (C. T. 7 and 8).

Jury trial was commenced before the Honorable William C. Mathes on Tuesday, September 18, 1962, at 11:00 a.m. (C. T. 24; R. T. 3). The trial continued on Wednesday, September 19, 1962, (C. T. 25; R. T. 135). At the close of the government's case in chief on the second day of trial, both appellants moved for a judgment of acquittal and both of said motions were denied. (C. T. 25; R. T. 226). On the same day, both appellants rested their respective cases (R. T. 237) and both appellants renewed their motions for acquittal and the motion was denied as to each defendant (R. T. 238 and 239). No rebuttal evidence was presented by the prosecution (R. T. 239). The case was submitted to the jury on Thursday, September 20, 1962, the third day of trial. (R. T. 245 and 278). On the same day a verdict of guilty was returned as to each appellant. (R. T. 286, 287). The cause was continued until October 5, 1962, for all further proceedings and the appellants were given leave to make motions for a new trial. (R. T. 292-295; C. T. 26). On October 5, 1962, the Court entertained oral motions on behalf of both appellants for a new trial. (R. T. 300, 301; C. T. 27). Both appellants urged in support of their motions for new trial that the evidence was insufficient as a matter of law to support the conviction in that there was no evidence whatsoever that the narcotic had been imported into the United States contrary to law nor any evidence that either appellant had knowledge of any such unlawful importation. (R. T. 302-310) The motion for new trial was denied as to each appellant. (R. T. 311; C. T. 27.) On the same day each appellant was committed to the custody of the Attorney General

for a period of ten years. (R. T. 319; C. T. 28, 29.) Both appellants filed timely notices of appeal on October 12, 1962. (C. T. 30, 31)

### III.

#### SPECIFICATION OF ERRORS

1. The statute under which appellants were indicted, tried and convicted is invalid and unconstitutional under the provisions of the Fifth Amendment to the Constitution of the United States in that said statute provides in part:

"Whenever on trial for a violation of this section, the defendant is shown to have or to have had possession of the narcotic drug, such possession shall be deemed sufficient evidence to authorize conviction unless the defendant explains the possession to the satisfaction of the jury." (21 U. S. C., 174)

2. The evidence is insufficient as a matter of law to sustain the conviction of either appellant.

### IV.

#### STATEMENT OF FACTS

Ronald Rojas was contacted at his home on March 26, 1962, at 8:00 or 9:00 p.m. (R. T. 26) Rojas was identified by officers who participated in the investigation as an informer, (R. T. 62) or a special employee (R. T. 159). He had previously been arrested for addiction (R. T. 59) and had been observed under the influence of narcotics at a time previous to the time of the incident with which the instant appeal is concerned. (R. T. 89). On March 26, 1962, appellant Egishian

came into Rojas' home and asked the latter to come outside. The two went outside and both sat in Egishian's car and talked in the presence of appellant Agobian.

(R. T. 27). One or the other of appellants asked Rojas whether he could get rid of some heroin and Agobian informed Rojas that he, Agobian, had a certain amount of heroin he was attempting to sell. (R. T. 29). Rojas advised he could sell some of the heroin and they arranged a meeting for the following night. (R. T. 30).

The next evening Agobian and Egishian picked Rojas up at his home around 8:00 or 9:00 p.m. and drove to the residence of Egishian where they went into the garage. (R. T. 31). Qualifying his testimony with "I believe", Rojas testified Agobian produced what seemed to be loose heroin in a rubber container. (R. T. 31). Egishian went into the house to get milk sugar and produced a jar. (R. T. 31) Rojas and Agobian mixed both substances in the jar and the total amount after mixing was approximately one ounce. (R. T. 32). A meeting was then arranged for the following evening. (R. T. 32).

The following evening, March 28, 1962, appellants met Rojas about 6:00 p.m. in front of Rojas' place of employment which is a men's clothing store. (R. T. 33). They arrived in a powder blue 1941 Cadillac belonging to Egishian and all three proceeded to the residence of Rojas. (R. T. 34). At that time Rojas was advised they did not have the heroin and he instructed them to leave him at his place of residence and go get the heroin. Earlier in the day of March 28, 1962, Rojas had contacted Sgt. Cook and Officer Weldon of the Sheriff's Narcotic Detail. (R. T. 35). At a later time Rojas observed appellants in the alley in the same powder blue 1941 Cadillac. (R. T. 36). Rojas admitted that he was a user of narcotics in March of 1962, (R. T. 45) but did not recall whether he had used on March 28,



1962. (R. T. 48).

The events which commenced with meeting Rojas at his place of employment at approximately 6:00 p.m. on March 28 and continued thereafter were surveilled and participated in to varying degrees by officers of federal and state investigating agencies including Penn R. Weldon of the Sheriff's Office (R. T. 53); William D. Stoops of the Sheriff's Office (R. T. 67); Jim Henry of the Sheriff's Office (R. T. 105); Raymond Velasquez of the Sheriff's Office (R. T. 63); and agents Richard Rock and Francis Briggs of the Federal Bureau of Narcotics (R. T. 137, 215).

Deputies Weldon and Stoops observed appellants circling the area of Rojas' employment at approximately 6:00 p.m. on March 28, 1962. (R. T. 54, 57). The officers were there because of the fact their agency had previously been contacted by Rojas. (R. T. 54). Rojas was observed entering the vehicle driven by Egishian and the vehicle was followed into an alley where Rojas departed. (R. T. 54, 55, 57). The Cadillac left the area and visual contact was lost. (R. T. 55). At approximately 6:30 p.m. the 1941 powder blue Cadillac returned to the area with Egishian driving and Agobian still a passenger. (R. T. 55, 77). The vehicle came to a stop at which time Deputies Weldon and Velasquez with Agent Briggs approached the passenger's side, Weldon identifying himself as a deputy sheriff. (R. T. 55, 56, 76, 164) Deputy Stoops driving a vehicle occupied by Agent Rock and Deputy Henry pulled in behind the Cadillac and to its left side. (R. T. 78) Deputy Henry approached the driver's side of the Cadillac and identified himself as a sheriff and said "Freeze". (R. T. 76, 106, 164). Deputy Velasquez approached the vehicle

on foot from the driver's side and stated "Sheriff's officers". (R. T. 165) At that point the Cadillac began moving rapidly in reverse out of the alley and continued in reverse for approximately one-half block after leaving the alley in an erratic manner until it came to rest after striking a parked vehicle. (R. T. 56, 57, 58, 79, 106). Deputies Weldon, Henry and Velasquez fired at the vehicle. (R. T. 63, 119, 166). Deputy Weldon and Agent Rock testified they saw nothing fall from the vehicle. (R. T. 65, 158). However, Deputy Stoops testified he observed an object thrown from the passenger's side of the Cadillac. (R. T. 79) Although Deputy Velasquez was firing his weapon (R. T. 166) he testified that he heard glass shattering as the Cadillac was backing up erratically. (R. T. 167). Deputy Velasquez testified that after the Cadillac came to rest he observed Agobian put both of his hands out and Agobian dropped a small package which Velasquez instructed Agent Rock to retrieve. (R. T. 168, 169, 214). Agent Rock and Deputy Velasquez subsequently searched the vehicle and found no heroin. (R. T. 162, 196). Velasquez did, however, take two tablets from Agobian which were not heroin. (R. T. 181).

Exhibit 1C was a powdery substance retrieved from the gutter by Agent Rock, (R. T. 143) which was analyzed and found to be one-half of one gram of heroin. (R. T. 15, 17).

Exhibit 2B was found to be approximately one-half of one gram of heroin, (R. T. 16, 18) taken from a jar lid found 80 feet west of the place where the Cadillac struck the parked automobile. (R. T. 139, 142, 146, 183).

Exhibit 3B constituted approximately 3/10 of one gram of heroin. (R. T. 16, 18) scraped up from blotches of powder approximately 20 feet from the alley by Deputy Stoops. (R. T. 81, 140).



Exhibit 4 consisted of glass fragments retrieved by Agent Rock near the jar lid which was found approximately 80 feet west of the place where the vehicle occupied by appellants came to rest. (R. T. 142, 185).

After his arrest, Egishian was interviewed by Deputy Henry in the presence of Agent Rock. (R. T. 109, 110). Egishian stated that he was going to meet a party by the name of Ronnie Rojas concerning a clothing deal, (R. T. 110) that Rojas lived in a house in the alley but Egishian did not know which one. They had gone to Worth's Clothing Store but could not make contact with Rojas so had come to his house. (R. T. 111) Egishian stated he picked the party up at Paul's Drive-in and they proceeded to Worth's and from there to the location of the arrest. (R. T. 114) The record is totally devoid of any statement by Egishian to the officers concerning narcotics.

Agobian was interviewed by Agent Briggs at the sheriff's station. (R. T. 215). Agobian stated that he had come from Riverside that afternoon to visit his wife and had been driving around with Egishian looking for a person by the name of Ronnie. (R. T. 217). Agobian denied having been further west than Atlantic although Agent Briggs testified that Worth's Clothing Store is a mile and one-half to two miles west of Atlantic Boulevard. (R. T. 217). Agobian stated he had gone to the alley with Mr. Egishian and that he didn't know what had happened. When the officers approached, all of a sudden the car went in reverse and he ducked down in the passenger's seat. At about the same time he heard some glass breaking. (R. T. 217 - 219). With respect to Agobian, the record is also devoid of any statement by him to the officers concerning heroin.

Russell Goudy was called by Egishian (R. T. 227) and testified that he came

out of his front door just after the vehicles collided (R. T. 233) and did not see anything thrown from the car nor did he see any hand reach out of the windows of the vehicle. (R. T. 232)

## V.

### ARGUMENT

A. The Statute Under Which Appellants Were Indicted, Tried and Convicted Is Invalid and Unconstitutional as Being Violative of the Fifth Amendment to the Constitution of the United States.

The Fifth Amendment to the Constitution of the United States provides in part as follows:

"No person shall be \*\*\* compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; \*\*\*\*"

The statute under which appellants were charged, tried and sentenced provides in part as follows:

"Whenever on trial for a violation of this section the defendant is shown to have or to have had possession of the narcotic drug, such possession shall be deemed sufficient evidence to authorize conviction unless the defendant explains the possession to the satisfaction of the jury."

Title 21, U. S. C., Section 174.

It is submitted that the provisions of the statute just quoted and the provisions of the Constitution are irreconcilable and that the latter, therefore, must be held

invalid. Appellants are cognizant of the fact that the provision of law which they now challenge has been carefully considered and sustained by numerous decisions, e. g. Yee Hem v. United States, 268 U.S. 178 (1925); Bradford v. United States, 271 F.2d 58, 60-61 (9th Cir. 1959); Cellino v. United States, 276 F.2d 941, 943-946 (9th Cir. 1960); Cutchlow v. United States, 301 F.2d 295, 297 (9th Cir. 1962). It is submitted, however, that the provisions of Title 21, United States Code, Section 174, making possession of a narcotic sufficient of itself to convict a person of transportation or concealment of narcotics known by the defendant to have been imported in the United States contrary to law unless that possession is explained to the satisfaction of the jury should be, and indeed must be, re-examined in light of the decision by this Court in Russell v. United States, 306 F.2d 402 (9th Cir. 1962) and the decision and the language of the Supreme Court of the United States in United States v. Kahriger, 345 U.S. 22 (1953). In Russell v. United States, supra, the provisions of Title 26, United States Code, Section 5841 requiring registration of a firearm was struck down as being violative of the prohibition against self-incrimination guaranteed by the Fifth Amendment to the Constitution.

Appellants can see no logical distinction between a rule of law requiring the possessor of a firearm to register the same and a rule of law requiring a defendant in a criminal case after the close of the government's evidence to explain possession of a narcotic. Certainly the dilemma of the persons involved in these separate situations are the same and the sanctions the same, namely, the invoking of a criminal penalty unless the individual takes some action which is or might be detrimental to his liberty or life.



Furthermore, it would appear that the very vice which the majority opinion found did not exist with respect to the statute considered by the Supreme Court in United States v. Kahriger, supra, is certainly present in the statute of which appellants herein complain. In considering the constitutionality of Title 26, United States Code (Supp. V) Section 3285, imposing a tax on persons in the business of accepting wagers, Mr. Justice Reed spoke for the majority of the Court and sustained the statute noting:

"Under the registration provisions of the wagering tax, appellee is not compelled to confess to acts already committed, he is merely informed by the statute that in order to engage in the business of wagering in the future he must fulfill certain conditions." (United States v. Kahriger, supra, pages 32-33)

By its very nature, the provisions of Title 21, United States Code, Section 174, of which appellants complain, require testimony concerning past activities and require it under penalty of conviction. The unhappy plight of appellants herein at the close of the government's case is graphically illustrated by the dissenting opinion of Mr. Justice Black with which opinion Mr. Justice Douglas concurred in United States v. Kahriger, supra, wherein it was noted:

"\*\*\*I am sure that it creates a squeezing device contrived to put a man in federal prison if he refuses to confess himself into a state prison as a violator of state gambling laws. The coercion of confessions is a common but justly criticized practice of many countries that do not have or live up to a Bill of Rights. But we have a Bill of Rights that condemns

coerced confessions, however refined or legalistic may be the technique of extortion." (Page 37)

At the time of the events which transpired in Los Angeles on March 28, 1962, California had in force and effect a statute which provides in part:

"Except as otherwise provided in this division, every person who possesses any narcotic other than marijuana except on the written prescription of a physician, dentist, podiatrist, or veterinarian licensed to practice in this state, shall be punished by imprisonment in the state prison for not less than two years nor more than ten years, and shall not be eligible for release upon completion of sentence, or on parole, or on any other basis until he has served not less than two years in prison." Section 11500 Health and Safety Code, State of California (as amended Stats. 1959, c. 1112, p. 3193, section 3; Stats. 1961, c. 215, p. 1234, section 38; Stats. 1961, c. 274, p. 1301, section 1)

Appellants respectfully submit that the provisions of Title 21, United States Code, Section 174, of which they complain are irreconcilable with the opinions of United States v. Kahriger, supra, and the opinion of this Court in Russell v. United States, supra, and should be struck down.

Separate and apart from the problem of compulsory self-incrimination, the statute involved in the instant case should be carefully re-examined in light of the due process requirement of the Fifth Amendment of the Constitution of the United States. It would appear that in making possession alone sufficient evidence to



convict a person of transportation or concealment of a narcotic which had been imported into the United States contrary to law knowing that the narcotic had been so imported, Congress took a bootstrap approach to control what should be a problem for resolution by the individual states.

"\*\*\*Congress may not go beyond the powers delegated to the Federal Government under the Constitution of the United States. Congress may control traffic and narcotic drugs in accordance with its power over interstate and foreign commerce and under its tax power, but its ability to declare mere possession of a narcotic unlawful is doubtful." Griego v.

United States, 298 F.2d 845, 848, (10th Cir. 1962)

It would appear that there is simply no rational connection between possession of a narcotic and knowledge that the narcotic had been imported into the United States contrary to law. The matter should be re-examined in light of Mr. Justice McReynolds' dissenting opinion in Casey v. United States, 276 U.S. 413 (1928) at page 420 where he noted:

"The suggested rational connection between the fact proved and the ultimate fact presumed is imaginary."

Appellants submit that a fair and objective re-evaluation of the provisions of Title 21, United States Code, Section 174 compel the conclusion that the observation of Mr. Justice McReynolds is correct.

B. The Evidence Is Insufficient as a Matter of Law to Support the Conviction of Either Appellant.

Assuming arguendo that the provisions of Title 21, Section 174 making

evidence of possession a sufficient predicate for inferring unlawful importation and knowledge thereof, then it is submitted the evidence in the instant case was insufficient to invoke this rule of law. Appellants take the position that the government's case must stand or fall based on the showing of possession of the heroin retrieved near the place where their vehicle collided with a parked auto (Exhibit 1C, R. T. 143, 168, 185, 214; Exhibit 2B, R. T. 139, 146, 183; Exhibit 3B, R. T. 140, 223) which substances were examined by an expert and found in truth and fact to be heroin. (R. T. 15, 16, 17, 18). Although the informer Ronald Rojas testified concerning the handling of heroin on the preceding evening, it should be noted that (R. T. 31, 32) this substance was never analyzed nor a sample taken therefrom which would justify conviction predicated on Rojas' testimony.

Turning to an analysis of the events which transpired on March 28, 1962, they simply show that a vehicle driven by Egishian in which Agobian was a passenger stopped in an alley and when officers of the Sheriff's Department approached, the vehicle was placed in reverse and backed out of the alley rapidly. As the vehicle proceeded erratically down the street, an object was seen to be thrown out of the vehicle through the passenger's window by one deputy and another deputy heard glass breaking. After the vehicle came to rest, one deputy testified that for a fleeting instant he saw appellant Agobian's hands come out of the automobile and a cellophane packet drop which was ultimately examined and found to contain heroin. It is submitted that this evidence of possession is entirely speculative as to appellant Egishian and even taking the evidence of the government in a light most favorable, it shows at the most a fleeting possession by appellant Agobian. For this reason they respectfully submit that the same results should obtain as to them as obtained

as to the defendant Narducci in United States v. Santore, et al., 290 F.2d, 51 (2d Cir. 1960) Cert. denied 365 U. S. 834. The disposition of that case as to Narducci can best be illustrated by the following excerpts from the opinion:

"\*\*\*The evidence presented by the Government shows that on the night in question Narducci was observed furtively attempting to remove a package containing narcotics from the trunk of a parked automobile. Tarlentino then met with Napolitano and Tolentino and explained to them that 'the kid got scared and left the package in the car.' The next morning, upon their arrest, Narducci impliedly admitted that he knew that the package contained narcotics,\*\*\*" (290 F.2d at page 64)

"\*\*\*The Government argues that Narducci's momentary grasp of the package constituted 'possession' of it by him, and that at that moment the crimes with which he and Tarlentino were charged were completed. We cannot agree. A statutory presumption is valid only where there is a rational and not unreasonable connection between the ultimate fact to be presumed and the fact proved. Yee Hem v. United States, 1925, 268 U. S. 178, 45 S.Ct. 470, 69 L.Ed. 904, supra. The crime punishable under section 174 is not the possession of narcotics, but rather the transporting, concealing, receiving, buying or selling of narcotics; and, consequently, in order to make the statutory presumption contained in that



section meet the test of validity we must define 'possession' as used therein so as to include only that type of control from which it could not unreasonably be inferred that the possessor was going to commit one or more of the specified acts which have been declared criminal. Narducci's grasp of the package was clearly not such possession, for he voluntarily released it one brief moment later." 290 F.2d pages 64-65.

"\*\*\*We agree with the original panel's opinion that his momentary grasp did not amount to the possession required in order to activate the statutory presumption against him." 290 F.2d at p. 79.

## VI.

### CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the District Court as to each appellant should be reversed.

Respectfully submitted:

PETER J. HUGHES

Attorney for Appellants

## CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

PETER J. HUGHES





No. 18635

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

ALBERT AGOBIAN and ALBERT EGISHIAN,

*Appellants,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

## APPELLEE'S BRIEF.

---

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**FILED**

**AUG 28 1963**

**FRANK H. SCHMID, CLERK**



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No. 18635  
IN THE  
**United States Court of Appeals**  
FOR THE NINTH CIRCUIT

---

ALBERT AGOBIAN and ALBERT EGISHIAN,

*Appellants,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

**APPELLEE'S BRIEF.**

---

I.

**JURISDICTION AND STATEMENT OF  
THE CASE.**

On April 18, 1962, the Appellants Albert Agobian and Albert Egishian were indicted by a Federal Grand Jury for the Southern District of California, in a single count which charged that on or about March 28, 1962, the appellants knowingly and unlawfully received, concealed and facilitated the concealment and transportation of a certain quantity of illegally imported heroin in violation of Title 21, United States Code, Section 174. [C. T. 2.]\*

On motion of the appellants the case was transferred to the Southern Division of the Southern District of California for trial and all further proceedings. [C. T. 7-8.]

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\*C. T. refers to Clerk's Transcript.

On September 20, 1962, the appellants were convicted in the United States District Court for the Southern District of California, the Honorable Wm. C. Mathes presiding, upon a jury verdict of guilty.

On October 5, 1962, each appellant moved for a new trial and both motions were denied. [C. T. 27.]

Appellants were each sentenced to imprisonment for ten years on October 5, 1962; and on October 12, 1962, each appellant gave notice of appeal. [C. T. 28-31.]

The jurisdiction of the District Court was predicated on Title 18, United States Code, Section 3231, and this Court has jurisdiction to entertain this appeal under the provisions of Title 28, United States Code, Sections 1291 and 1294.

## II.

### STATUTE INVOLVED.

Title 21, United States Code, Section 174, provides in pertinent part:

“Whoever fraudulently or knowingly imports or brings any narcotic drug into the United States . . . contrary to law, or receives, conceals, buys, sells, or in any manner facilitates the transportation, concealment or sale of any such narcotic drugs after being imported or brought in, knowing the same to have been imported or brought into the United States contrary to law . . . shall be imprisoned not less than five or more than twenty years and, in addition may be fined not more than \$20,000.

“Whenever on trial for a violation of this section the defendant is shown to have or to have had possession of a narcotic drug, such possession shall be deemed sufficient evidence to authorize conviction unless the defendant explains the possession to the satisfaction of the jury.”

III.

STATEMENT OF FACTS.

On the evening of March 26, 1962, the appellants, Albert Agobian and Albert Egishian first approached Mr. Ronald Rojas with a "business proposition." [R. T. 26.]\* Unknown to the appellants, Mr. Rojas was a special employee of the Government. [R. T. 61, 66, 103.] The appellants explained that they possessed a supply of heroin but Mr. Agobian's former "salesman" had been arrested. [R. T. 29-30.] Mr. Rojas agreed to sell heroin on behalf of the appellants. Since the appellants current supply of heroin would have to be "cut" or diluted in order to be marketable, arrangements were made to meet the following evening. [R. T. 52.]

At approximately 8:00 P.M., on March 27, 1962, the appellants picked up Mr. Rojas and drove to the residence of the appellant, Albert Egishian. [R. T. 31.] Upon arrival, the appellant Albert Agobian produced a quantity of heroin in a rubber container, and, the appellant Albert Egishian supplied the milk sugar with which to "cut" or dilute the heroin. [R. T. 31.] The heroin was placed in a glass jar with an equal amount of milk sugar. After "cutting," there was approximately one ounce of heroin. [R. T. 32.]

The appellants stated that they would deliver the heroin to Mr. Rojas on March 28, 1962. [R. T. 33.] When last seen by Mr. Rojas, the heroin was contained in a glass jar with a metal lid. [R. T. 32.]

At approximately 6:00 P.M., on March 28, 1962, the appellants picked up Mr. Rojas at Worth's Clothing

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\*R. T. refers to Reporter's Transcript.



Store. The appellants drove Mr. Rojas to his residence on Madison Avenue in Los Angeles. The appellants stated that they would return immediately with the heroin. [R. T. 34-35, 54-55, 76-77.]

At 6:30 P.M., on March 28, 1962, agents of the Federal Bureau of Narcotics and officers of the Sheriff's Department, Narcotic Detail, were stationed in the area of Mr. Rojas' residence on Madison Avenue. They observed a 1941 Cadillac, powder blue in color, drive down Madison Avenue and enter the alley adjoining Mr. Rojas' residence. The appellant Albert Egishian was driving and the appellant Albert Agobian was a passenger. There were no other occupants in the vehicle. [R. T. 55, 77-78.] After the vehicle had stopped in the alley, Deputy Sheriff Weldon went to the passenger side of the car. He observed that the appellant Albert Agobian was looking directly at Deputy Sheriff Weldon. In a loud voice, Deputy Sheriff Weldon called "Sheriff's Department, open the door," while displaying his badge in his left hand. [R. T. 56, 63.] Deputy Henry stood at the driver's door and shouted, "Sheriff, freeze." [R. T. 106.]

After the officers had identified themselves, the appellants attempted to escape. At a high rate of speed, the appellants drove in reverse out of the alley. In the process, the appellants' vehicle struck and knocked down Deputy Sheriff Weldon. [R. T. 56.] After exiting from the alley, the appellants drove east on Madison Avenue in reverse, at a speed of 25 to 30 miles an hour, in an erratic manner. [R. T. 56-57.]

During the attempted escape, Deputy Sheriff Stoops observed an object being thrown from the passenger window of the appellants' vehicle. This occurred on

Madison Avenue at a location approximately 20 feet east of the alley. [R. T. 79.] It was also while the appellants' vehicle was at this location that Deputy Sheriff Velasquez heard the shattering of glass. [R. T. 167.] Thereafter, the officers observed a trail of powder and broken glass commencing on Madison Avenue 20 feet east of the alley, and terminating at the street curb. [R. T. 81, 151.] A metal jar lid containing a powdery substance was recovered at the curb. [R. T. 81, 139, 142, 152, 183.] The powder gathered from the asphalt pavement and the powder found in the metal jar lid were analyzed and found to be heroin. [R. T. 16, 144, 145.]

Both on foot and by car, officers followed the appellants' vehicle for its brief trip down Madison Avenue until the appellants struck a parked automobile. Immediately thereafter, Deputy Sheriff Velasquez observed the appellant Albert Agobian throw a cellophane bindle out the passenger window of the appellants' vehicle. [R. T. 168.] The contents of the bindle were analyzed and found to be heroin. [R. T. 15, 143, 190.]

Although the appellant Albert Egishian resisted arrest, he was finally taken into custody. [R. T. 108, 120, 124, 127-128.]

In searching the person of the appellant Albert Agobian after arrest, an amphetamine tablet and a seconal tablet were recovered from his left front shirt pocket. The appellant Agobian denied any knowledge of these tablets. [R. T. 181-183.]

The appellants were interviewed by the officers. Each appellant falsely denied seeing Ronald Rojas on March 28, 1962. [R. T. 114, 217-219.]

IV.

ARGUMENT.

A. 21 U. S. C. 174 Is Constitutional.

Appellants contend Section 174 of Title 21, United States Code, with its presumption, is unconstitutional as being violative of the Fifth Amendment to the Constitution of the United States. Sections 174 and 176(a) of the Narcotics Import and Export Act contain a substantially identical presumption; and, its constitutionality has been repeatedly upheld by the Supreme Court of the United States and by the Court of Appeals of this Circuit.

*Yee Hem v. United States*, 268 U. S. 178 (1925);

*Hooper v. United States*, 16 F. 2d 868 (9 Cir. 1926);

*Bradford v. United States*, 271 F. 2d 58 (9 Cir. 1959);

*Butler v. United States*, 273 F. 2d 436 (9 Cir. 1959);

*Cellino v. United States*, 276 F. 2d 941 (9 Cir. 1960);

*Cutchlow v. United States*, 301 F. 2d 295 (9 Cir. 1962);

*White v. United States*, 315 F. 2d 113 (9 Cir. 1963).

The constitutionality of the presumption sections has also been challenged on the ground that said provisions compel an accused to be a witness against himself. As was stated by this court in *Rosenberg v. United States*, 13 F. 2d 369 (9 Cir. 1926), at page 370:

“In no way is there compulsion that defendant shall testify. He may produce witnesses who may truthfully and without difficulty satisfy the jury that his possession was had in an honest and legitimate way. He may rely upon circumstances developed by the evidence of the prosecution as negating unlawful possession, or he may himself testify and explain how he became possessed of the drugs.”

The presumption is not unconstitutional as forcing a defendant to testify.

*Yee Hem v. United States*, 268 U. S. 178 (1925);

*Ng Choy Fong v. United States*, 245 Fed. 305 (9 Cir. 1917), cert. den. 245 U. S. 669;

*Mullaney v. United States*, 82 F. 2d 638 (9 Cir. 1936);

*Dear Check Quong v. United States*, 160 F. 2d 251 (D. C. Cir. 1947);

*Caudillo v. United States*, 253 F. 2d 513 (9 Cir. 1958).

## **B. The Evidence Is Sufficient to Sustain the Conviction.**

The Government respectfully submits that the evidence is sufficient to sustain the jury's verdict. Especially is this true when this Court, as it must, considers the evidence and inferences that can be drawn from it most favorably to the Government.

*Glasser v. United States*, 315 U. S. 60 (1941);

*Sandez v. United States*, 239 F. 2d 239 (9 Cir. 1956);



*Robinson v. United States*, 262 F. 2d 645 (9 Cir. 1959);

*Benchwick v. United States*, 297 F. 2d 330 (9 Cir. 1961);

*Young v. United States*, 298 F. 2d 108 (9 Cir. 1962);

*Debardleben v. United States*, 307 F. 2d 362 (9 Cir. 1962).

Several officers testified that Mr. Ronald Rojas was a special employee of the government. The officers further testified that past experience had proven Mr. Rojas was reliable. [R. T. 61, 66, 103.]

The testimony concerning the handling of heroin on the evening of March 27, 1962, clearly proved that the appellants intended to possess and continue dealing in the illicit traffic of narcotics. It is incongruous to permit the appellants to defend on the ground that the substance which they handled on March 27, 1962 was not proved to be heroin.

*Britton v. United States*, 60 F. 2d 772 (7 Cir. 1932).

“We note that by the specific language of Section 174 Defendant must be ‘*shown to have or to have had* possession of the narcotic drug.’ (emphasis added.)”

*Rodella v. United States*, 286 F. 2d 306, 310-311 (9 Cir. 1960).

Mr. Rojas testified that on March 28, 1962, the appellants were going to deliver heroin. At the appointed date and location the appellants arrived.

During the attempt by the appellants to escape, an object was thrown from the appellants’ moving vehicle



and the sound of glass breaking was heard. At this precise location, heroin was scraped from the asphalt pavement. Broken glass and a metal jar lid containing heroin were also recovered. That this heroin was in fact thrown from the appellants' vehicle is substantiated by the testimony of Deputy Sheriff Velasquez that no other broken glass was found along the route of the appellants' attempted escape. Nor were there any broken windows in the appellants' vehicle. The only rational conclusion that can be drawn from these facts is that the heroin recovered on March 28, 1962 is the same heroin which was "cut" by the appellants and stored in a glass jar with a metal lid on the evening of March 27, 1962.

"When at the approach of the officers the jar containing the heroin was thrown out of the window of appellant's residence it was shown that a moment earlier someone had had possession of narcotics. In the absence of explanation showing the possession to be lawful it was presumed unlawful under 21 U.S.C.A. Section 174. That the corpus delicti of the offense charged was fully established . . . ."

*Cutchlow v. United States*, 301 F. 2d 295, 297  
(9 Cir. 1962).

Appellee submits that this evidence standing alone would sustain the conviction. But in addition, there is the irrefutable evidence that after the appellants' vehicle struck a parked automobile, an officer observed the appellant Albert Agobian throw away a bindle of heroin.

Since reasonable minds as triers of the fact, could find that the evidence excludes every reasonable hypoth-

esis but that of guilt, appellee submits that the verdict of the jury must be sustained.

*Remmer v. United States*, 205 F. 2d 277 (9 Cir. 1953) ;

*Bolen v. United States*, 303 F. 2d 870 (9 Cir. 1962) ;

*Farrell, et al. v. United States*, ..... F. 2d ....., No. 18,241 (9th Cir. Aug. 7, 1963).

V.

### CONCLUSION.

For the reasons stated above, the judgment of the District Court should be affirmed.

Respectfully submitted,

FRANCIS C. WHELAN,  
*United States Attorney,*

THOMAS R. SHERIDAN,  
*Assistant U. S. Attorney,*  
*Chief, Criminal Section,*

JO ANN DUNNE,  
*Assistant U. S. Attorney,*  
*Attorneys for Appellee.*

### **Certificate.**

I certify that, in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with these rules.

JO ANN I. DUNNE,  
*Assistant U. S. Attorney.*



No. 18636

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

JAMES MELVIN LUCAS,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

## APPELLEE'S BRIEF.

---

FRANCIS C. WHELAN,  
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No. 18636

IN THE

**United States Court of Appeals**  
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JAMES MELVIN LUCAS,

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*vs.*

UNITED STATES OF AMERICA,

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---

**APPELLEE'S BRIEF.**

---

**I.**

**JURISDICTIONAL STATEMENT.**

The appellant was indicted on October 31, 1962, and convicted on December 11, 1962, under the provisions of Section 751 of Title 18, United States Code. Judgment was entered on January 14, 1963 [C. T. 11].

The jurisdiction of the District Court rested on Section 3231 of Title 18, United States Code.

A timely notice of appeal was filed on January 15, 1963. [C. T. 14.]<sup>1</sup>

This court has jurisdiction under Sections 1291 and 1294 of Title 28, United States Code.

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<sup>1</sup>C. T. refers to Clerk's Transcript of Record.

II.

STATEMENT OF THE CASE.

A Three-Count Indictment charging a violation of Section 751, Title 18, United States Code, was returned by the Grand Jury on October 31, 1962. Appellant was named in Count Three of the Indictment which charged substantially as follows:

That on or about October 12, 1962, in San Luis Obispo County, California, within the Central Division of the Southern District of California, defendant James Melvin Lucas, who was then in the custody of and confined by direction of the Attorney General at the Federal Correctional Institution, Lompoc, California, following his conviction in United States District Court, District of Arizona, of a violation of 18 United States Code, Section 2312, escaped from such custody and confinement. [C. T. 2.]

Counts One and Two charge William Purvis Beaugez, Jr., and LeRoy Taylor, respectively, with escape from the same institution on the same date. [C. T. 2, 3.] Both Beaugez and Taylor plead guilty as charged.

On December 11, 1962, at 10:00 A.M., in the chambers of the Honorable Leon R. Yankwich, Mrs. Lundberg, attorney for appellant Lucas, requested to read a statement to Judge Yankwich because "as a result of this he may waive a jury trial entirely and leave it up to your Honor." [R. T. 4, 5.] The Court gave its assent and Mrs. Lundberg read the following statement at that time.

"By reason of illegality being held, violation of my constitutional rights, failure of the judge in



previous case to provide me with adequate counsel. The only reason that I left Lompoc was as follows:

“On October 31, 1960 in Tucson, Arizona, when I appeared before Judge Walsh he asked me how do you plead. I told him that I was not guilty, but that I was going to plead guilty, only because I could not stand the bedbugs and vermin in the County Jail. The attorney of record, who was appointed by the Court, did not appear at the time of plea or sentencing. After I was sentenced he visited me and told me that he was now ready to start fighting the case. I honestly believed him, and I know nothing about the law. But if the judge had protected my legal rights at that time, I would not have been sentenced to Lompoc. Also when I stated this in Court, the judge had the clerk read it back to him. The basis of my conviction was a car that was loaned to me by a friend. He did not, or would not prosecute, or appear against me as a complaining witness.

“This will all be substantiated by the transcript of that case. And if this judge is just, fair, and honest, he will have those records sent for. And he will also find that escape is impossible from an institution when you are being illegally held.

“There was no intent to escape, as I honestly felt that I was being illegally held. And not knowing law, this was the only method that I could employ, to get back into a Federal Court. Had I known the law, at the time of my sentencing, I would have appealed this case. But I was under the impression that even the judge would protect my rights. The

previous trial was nothing but a sham and frivolous imitation of a kangaroo court, and I honestly feel that this judge can correct a miscarriage of justice.

“I will waive jury trial with the stipulation that certain evidence be brought in that is pertinent to the case and basis of this charge.” [R. T. 5, 7.]

Having read the above statement to the judge, the appellant Lucas waived jury trial [C. T. 5, R. T. 10], and was tried on December 11, 1962, before the Honorable Leon R. Yankwich [C. T. 5], and was found guilty on the same date.

On January 14, 1963, appellant was sentenced to the custody of the Attorney General for treatment and supervision pursuant to Section 5010(b), of Title 18, United States Code, until discharged by the Federal Youth Correctional Division of the Board of Parole as provided in Section 5017(c) of Title 18, United States Code, and it was further ordered that this sentence commence at the expiration of the sentence now being served. [C. T. 5, 10, 11.]

Appellant Lucas sent a letter on February 8, 1963, to the judge which was treated as a motion for modification of the sentence, and on February 12, 1963, this motion was denied. [C. T. 12, 13.]

A timely notice of appeal was filed on January 15, 1963. [C. T. 14.]

Appellant assigns the following errors:

1. The finding of guilty and judgment thereon was not supported by substantial evidence.

2. The appellant was denied due process of law within the meaning of the Fifth Amendment to the United States Constitution because:

(a) The finding of guilt was not supported by substantial evidence, and

(b) There was bias and prejudice on the part of the trial court in its attitude toward the appellant.

### III.

#### STATUTES INVOLVED.

Section 751, of Title 18, United States Code, provides:

“Whoever escapes or attempts to escape from the custody of the Attorney General or his authorized representative, or from any institution in which he is confined by direction of the Attorney General, or from any custody under or by virtue of any process issued under the laws of the United States by any court, judge, or commissioner, or from the custody of an officer or employee of the United States pursuant to lawful arrest, shall, if the custody or confinement is by virtue of an arrest on a charge of felony, or conviction of any offense, be fined not more than \$5,000 or imprisoned not more than five years, or both; or if the custody or confinement is for extradition or by virtue of an arrest or charge of or for a misdemeanor, and prior to conviction, be fined not more than \$1,000 or imprisoned not more than one year, or both.”

Section 144, of Title 28, United States Code, provides:

“Whenever a party to any proceeding in a district court makes and files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to hear such proceeding.

“The affidavit shall state the facts and reasons for the belief that bias or prejudice exists, and shall be filed not less than ten days before the beginning of the term at which the proceeding is to be heard, or good cause shall be shown for failure to file it within such time. A party may file only one such affidavit in any case. It shall be accompanied by a certificate of counsel of record stating that it is made in good faith.”

#### IV.

#### STATEMENT OF THE FACTS.

The appellant was convicted of interstate transportation of a stolen motor vehicle, a violation of Title 18, U. S. C., Section 2312, in United States District Court, District of Arizona, in 1960, and sentenced to the custody of the Attorney General for an indeterminate sentence under the Youth Corrections Act. [R. T. 13, 47.]

Appellant was confined in the Federal Prison in Englewood, Colorado. [R. T. 47.] While at Englewood appellant attempted to escape and was then sent

to the Federal Correctional Institution at Lompoc, California, in June of 1961. [R. T. 37, 48.]

In July 1962, while still at Lompoc, appellant was assigned as a medium O.W.O. inmate which meant that he could work outside the fence under the supervision of an officer. [R. T. 16, 17.]

On October 12, 1962, appellant was assigned to outside labor detail picking walnuts under the supervision of Lompoc Correctional Officer Steney L. Johnson, under whom the appellant had been working since July 25, 1962. [R. T. 14, 87.]

At the lunch period on October 12, 1962, appellant, together with inmates Leroy Taylor and William Purvis Beaugez, Jr., discussed how the prison was running and decided to escape. [R. T. 27, 50, 51.]

During the lunch period there was nothing unusual about appellant's demeanor [R. T. 30], and after the decision to escape was made the appellant appeared quiet and serious. [R. T. 35.]

After the conclusion of the lunch hour the detail of nine inmates under the supervision of officer Johnson resumed their work in the walnut orchard. [R. T. 15, 18.] The prison guard stationed himself approximately 10 to 20 feet away from the detail of prisoners as they picked walnuts [R. T. 64], and if any prisoner missed a walnut the guard would instruct him to pick it up. [R. T. 73.] The guard who had supervised the appellant on this particular detail for approximately three months observed no erratic or unusual behavior on the part of the appellant; no incidents occurred; and there was no departure of standard operating procedure during the afternoon. [R. T. 17, 84, 85, 87, 89.]



At approximately 3:25 P.M., officer Johnson informed the appellant and the rest of the nine inmates that it was time to quit work. [R. T. 15, 89.] Officer Johnson then turned his back and led the detail toward the north side of the orchard. [R. T. 15.]

The appellant and inmates Taylor and Beaugez chose this moment to make their escape [R. T. 27, 38], and the three ran from the orchard, climbed a barbed wire fence, ran across a ploughed field to the Santa Ynez River bed which is located 200 yards from the orchard. [R. T. 17, 28, 42, 52.]

Approximately two to three minutes after officer Johnson had turned his back on the detail he noticed that appellant Lucas, Taylor and Beaugez were missing from the detail, and immediately returned to the area in which they were working and conducted an unsuccessful search for the missing inmates. [R. T. 15.]

Appellant Lucas and the two other inmates alternatively ran and walked approximately 40 miles up the Santa Ynez River bed to the Cachuma Dam where they stole a pick-up truck by "hot wiring it" [R. T. 17, 22, 28, 32, 43], and headed south. The next evening, October 13, the California Highway Patrol picked them up at a road block near Ventura, California [R. T. 22, 25], and jailed them in the Ventura County Jail [R. T. 20.]

On October 14, 1962, at 12:30 A.M., Cyril Myhand, a Lieutenant at the Federal Correctional Institution, Lompoc, California, picked up the appellant Lucas, to-

gether with the other two inmates at Ventura County Jail and transported them back to the institution at Lompoc. [R. T. 20.] During the trip back to Lompoc all three stated that they didn't plan the escape but did it on the spur of the moment. [R. T. 21.] Appellant Lucas, during this trip stated that the three of them had made two mistakes and that the last one was that "they got caught, they stopped at the road block". [R. T. 23.]

## V.

### QUESTIONS PRESENTED.

The first question presented is whether or not the finding of guilt was supported by substantial evidence.

The second question is whether or not the appellant was denied due process of law within the meaning of the Fifth Amendment to the Constitution, because bias and prejudice on the part of the trial court was shown in its attitude toward the appellant.

## VI.

### SUMMARY OF ARGUMENT.

A. There is Substantial Evidence to Support the Verdict of the Trier of Fact.

B. Appellant was not Denied Due Process of Law within the Meaning of the Fifth Amendment to the Constitution.

1. The appellant has waived any objection to the trial judge on the basis of any possible bias and prejudice.

2. There was no bias or prejudice on the part of the trial court in its attitude toward the appellant.

VII.

ARGUMENT.

A. Sufficiency of the Evidence.

In a prosecution for a violation of Title 18, United States Code, Section 751, Escape from the Custody of the Attorney General, there must be proof of three facts, as stated in *Hardwick v. United States* (9 Cir. 1961), 296 F. 2d 24,

“(a) that there was a conviction (b) that there was an escape and (c) that such escape was from a confinement arising by virtue of the conviction.”

The Government's evidence has been fully summarized in the Statement of Facts and will not be re-detailed here. Each of the elements of the offense was amply proven by the evidence. The appellant stipulated that he was convicted of interstate transportation of a stolen motor vehicle in Federal District Court in Arizona in 1960, and by virtue of this conviction was confined at the Federal Correctional Institution at Lompoc, California, on October 12, 1962. [R. T. 13.]

There is extensive evidence that the appellant escaped from Lompoc on October 12, 1962, along with two other inmates of the institution. [R. T. 15, 17, 22, 28, 32, 42, 43, 52.]

Viewing the evidence in the light most favorable to the Government, there was more than sufficient evidence to support the conviction.

“in appraising the sufficiency of the evidence, it is not necessary that this court be convinced beyond a reasonable doubt of the guilt of the defendant. On the motion for judgment of acquit-

tal, the question is whether the evidence viewed in the light most favorable to the prosecution, is such that a jury might find the defendant guilty beyond a reasonable doubt.”

*United States v. Sawyer* (4 Cir. 1961), 294 F. 2d 24, at p. 31.

If there is sufficient evidence for the trier of facts to pass upon, the finding should not be disturbed in the Court of Appeals.

*Sandez v. United States* (9th Cir. 1956), 239 F. 2d at p. 243.

See also,

*Glasser v. United States* (1941), 315 U. S. 60;

*Young v. United States* (9 Cir. 1962), 298 F. 2d 108, at p. 111;

*Robinson v. United States* (9 Cir. 1959), 262 F. 2d 645.

Appellant Lucas contends that there is a preponderance of evidence showing the lack of the requisite intent to escape and therefore the evidence is insufficient to convict him. A similar contention was made and rejected in *Radmacher v. United States* (5 Cir. 1960), 285 F. 2d 100. Here, as in *Radmacher*, there is more than ample evidence that the appellant had the requisite intent to escape. Appellant planned the escape with two other inmates [R. T. 27, 50, 51], and chose a moment when the guard's back was turned to effectuate it. [R. T. 27, 38.] The three escapees then traveled 40 miles up the Santa Ynez River at which time they stole and hot-wired a truck, and it was not until they were stopped by a California Highway Pa-



trol road block that they were returned to custody. [R. T. 17, 22, 25, 28, 32, 43.]

Appellant further contends that he was unable to form any intent due to the fact that he had been drinking "raisin jack" and chewing "jimson weed." A somewhat similar defense was alleged in *Mills v. United States* (5 Cir. 1951), 193 F. 2d 174. In *Mills* the court held that the evidence was insufficient to sustain the defense that the defendant did not intend to escape and that he had taken so many pills that he did not know what he was doing. We have the same situation in the instant case. The evidence shows that the appellant was under close supervision by the prison guard during the day that he escaped, was acting normally, and was able to effectuate a clever escape. [R. T. 17, 22, 23, 28, 30, 32, 35, 42, 43, 52, 73, 84, 85, 87, 89.]

**B. The Appellant Was Not Denied Due Process of Law Within the Meaning of the Fifth Amendment to the Constitution.**

1. The appellant has waived any objection to the trial judge on the basis of any possible bias and prejudice.

Appellant Lucas did not file a timely and sufficient affidavit of bias and prejudice of the trial court as required by Title 28, Section 144.

Appellant Lucas requested that the trial court listen to his statement which was read by his attorney prior to trial. After having this statement read to the judge, the appellant then waived trial by jury. [R. T. 4-9.] Appellant raises the question of bias for the first time in this court, and thereby waived any assertion of constitutional infirmity in his conviction.



As stated in *Pacheco v. People of Puerto Rico* (5 Cir. 1962), 300 F. 2d 759, at p. 760:

“If a judge is subject to disqualification, the party concerned must complain promptly. He cannot be allowed to wait to see how the judge decides. In re United Shoe Machinery Corp., 276 F.2d 77. 79 (C.A.1, 1960).”

In *Yakus v. United States* (1944), 321 U. S. 414. 64 S. Ct. 660, 88 L. Ed. 834, the United States Supreme Court said:

“No procedural principle was more familiar to this court than that a constitutional right may be forfeited in criminal as well as civil cases by the failure to make timely assertion of the right before a tribunal having jurisdiction to determine it.”

2. The record indicates no bias or prejudice on the part of the trial court in its attitude toward appellant Lucas. The suggestion of appellant on page 34 of his brief that the “trial court was unable to erase the memory of appellant’s statement from its mind,” and thus “did not weigh the evidence presented in court,” are not statements of fact supported by the record, but merely conclusions or conjectures on the part of the appellant. The record shows that the trial judge weighed the evidence impartially, and committed no error by sitting as the trier of fact in this case.

*Willenbring v. United States* (9 Cir. 1962), 306 F. 2d 944.

**Conclusion.**

There being no error, the judgment of the court below should be affirmed.

Respectfully submitted,

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*Chief, Criminal Section,*

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*Attorneys for Appellee,*  
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### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

NORMAN OLLESTAD,  
*Assistant U. S. Attorney.*



NO. 18641

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FOR THE NINTH CIRCUIT

FOREST G. SMITH, JR. and  
ROSE MARY SMITH,

Appellants,

vs.

COMMISSIONER OF INTERNAL  
REVENUE,

Appellee.

---

BRIEF FOR THE APPELLANTS

---

ON PETITION  
FOR REVIEW OF DECISION OF  
THE TAX COURT OF THE UNITED STATES

---

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Appellee.

---

BRIEF FOR THE APPELLANTS

---

OPINION BELOW

The opinion of the Tax Court was filed on May 28, 1962, and its decision, based upon said opinion, and whose review is sought in this appeal, was entered December 13, 1962 (R. 418-434, 436).

JURISDICTION

The Tax Court had jurisdiction of this matter under Section 7442 of the Internal Revenue Code of 1954 (26 USCA 7442) and Section 6213 of the Internal Revenue Code of 1954 (26 USCA 6213). This Court has jurisdiction under Section 7482 of the Internal





This petition for review involves deficiencies in the petitioners' Federal income taxes for the calendar years 1954, 1955 and 1956 (R. 437-439). On April 29, 1960, the Commissioner of Internal Revenue mailed to the taxpayers, by registered mail, a notice of deficiency covering said years (R. 12-20).

The taxpayers filed a petition for redetermination with the Tax Court on July 15, 1960 (R. 5-20). On September 7, 1960, the Commissioner filed an answer to the taxpayers' petition (R. 21). On April 10, 1961, pursuant to leave granted by the Tax Court taxpayers filed an amendment to their petition therein alleging that no sale of Clock Restaurants took place in 1956 and that the Commissioner of Internal Revenue had erred in failing to allow a loss carry-back to the year 1954 of \$101,888.73 resulting from the sale of Clock Country Club in the calendar year 1956 (R. 23-27). On April 13, 1961, the respondent filed an amended answer in the proceeding before the Tax Court wherein an additional deficiency of \$5,735.29 was asked for the calendar year 1956 (R. 29-30).

On March 28, 1962, the Tax Court filed its opinion (R. 418-434). The Tax Court's decision whose review is sought in this proceeding was entered December 13, 1962 (R. 436). The case is brought to this Court by a Petition for Review filed with the Tax Court on March 11, 1963 (R. 437-439). At the same time the petitioners filed the following statement of points upon which they intend to rely in this review:

1. The Tax Court erred in finding as a fact that as a

- 2.



part of the consideration for Smith's sale of Clock Restaurants to Peterson, the latter assumed \$603,687.96 of Smith's liabilities which pertained to said restaurants when the evidence before the Tax Court was that instead of assuming the liabilities of Smith, Peterson merely took the assets of Clock Restaurants subject to said liabilities.

2. The Tax Court erred in finding as a fact that the sale by Forest G. Smith, Jr., of the Clock Restaurants to Robert O. Peterson was a closed and completed transaction in the calendar year 1956 for the reason that the evidence before the Tax Court did not support such a finding of fact but required a finding of fact that the sale was not completed until subsequent to January 1, 1957.

3. The Tax Court erred in concluding as a matter of law that no agency existed between the seller and purchaser of Clock Restaurants for the reason that said conclusion is supported neither by the evidence before the Tax Court nor the facts as found by the Tax Court.

4. The Tax Court erred in concluding that as a matter of law sale of Clock Restaurants was completed on October 30, 1956, for the reason that said conclusion of law is not supported by the evidence before the Tax Court.

5. The Tax Court erred in construing the written memorandum between Forest G. Smith, Jr. and Robert O. Peterson of October 30, 1956, concerning the sale of Clock Restaurants, as providing that Robert O. Peterson thereby assumed and agreed to pay the debts of Forest G. Smith, Jr., whereas said agreement,



by its terms, only provides that Robert O Peterson may take the assets of Clock Restaurants subject to the debts of Forest G Smith

6. The Tax Court erred in concluding, as a matter of law, that the transfer of petitioner's property subject to his debts was in substance the receipt of "money" in the amount of such debts within the meaning of §1001(b) of the Internal Revenue Code of 1954.

7. The Tax Court erred in failing and refusing to make a finding or conclusion as to whether or not the rights of Forest G. Smith, Jr. , under the memorandum agreement between himself and Robert O. Peterson of October 30, 1956, did or did not have a fair market value.

8. The Tax Court erred in deciding that there were deficiencies of \$53,359.65, \$5,952.10 and \$17,214.61 respectively in petitioner's Federal income taxes for the taxable years 1954, 1955 and 1956.

9. The Tax Court erred in failing to decide that there were overpayments of \$15,000.00, \$4,673.34 and \$1,645.43 respectively of petitioner's Federal income taxes for the taxable years 1954, 1955 and 1956 (R. 440-442).

### STATUTES AND REGULATIONS INVOLVED

#### Sixteenth Amendment to the Constitution of the United States:

##### "INCOME TAX

"The Congress shall have power to lay and collect taxes or incomes, from whatever source derived, without





apportionment among the several States, and without regard to any census or enumeration. "

Section 1001(b) Internal Revenue Code of 1954:

"(b) AMOUNT REALIZED

"The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. "

Treasury Regulation 1.1001-1(a):

"1(a) COMPUTATION OF GAIN OR LOSS

"The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property (other than money) received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. "

Section 172(a)(b)(1)(A) Internal Revenue Code of 1954:

"NET OPERATING LOSS DEDUCTION

"(a) Deduction Allowed - There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term 'net operating loss deduction' means the deduction allowed by this subsection.



"(b) Net operating loss carrybacks and carryovers --

"(1) Years to which loss may be carried - A net operating loss for any taxable year ending after December 31, 1953, shall be --

"(A) A net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss "

Section 172(c) Internal Revenue Code of 1954:

"NET OPERATING LOSS DEFINED

"For purposes of this section, the term 'net operating loss' means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d). "

Section 172(d)(4)(A) Internal Revenue Code of 1954:

"(d) MODIFICATIONS

"The modifications referred to in this section are as follows:

"(4) Nonbusiness deductions of taxpayers other than corporation - In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of gross income not derived from such trade or business. For purposes of the preceding sentence --

"(A) any gain or loss from the sale or other disposition of --





"(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

"(ii) real property used in the trade or business, shall be treated as attributable to the trade or business; . . . "

Treasury Regulations 1.172-3(a)(3)(ii):

"3(a) NET OPERATING LOSS IN CASE OF A TAX-PAYER OTHER THAN A CORPORATION

"Modification of deductions - A net operating loss is sustained by a taxpayer other than a corporation in any taxable year beginning after December 31, 1953, if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 of the 1954 Code over gross income computed thereunder; this rule shall apply even though the loss year is otherwise subject to the 1939 Code. In determining the excess of deductions over gross income for such purpose --

"(3)(ii) SALE OF BUSINESS PROPERTY

"Any gain or loss on the sale or other disposition of property which is used in the taxpayer's trade or business and which is of a character that is subject to the allowance for depreciation provided in section 167, or of real property used in the taxpayer's trade or business, shall be considered, for purposes of section 172(d)(4), as attributable to, or derived from,



the taxpayer's trade or business. Such gains and losses are to be taken into account fully in computing a new operating loss without regard to the limitation on nonbusiness deductions. Thus, a farmer who sells at a loss land used in the business of farming may, in computing a net operating loss, include in full the deduction otherwise allowable with respect to such loss, without regard to the amount of his non-business income and without regard to whether he is engaged in the trade or business of selling farms. Similarly, an individual who sells at a loss machinery which is used in his trade or business and which is of a character that is subject to the allowance for depreciation may, in computing the net operating loss, include in full the deduction otherwise allowable with respect to such loss. "

Section 1231(a)(1) and (b)(1)(A), (B), Internal Revenue Code of 1954:

"(a)     PROPERTY USED IN THE TRADE OR BUSINESS  
          AND INVOLUNTARY CONVERSIONS

"General Rule - If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof)



of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets.

For purposes of this subsection --

"(1) In determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the extent taken into account in computing taxable income, except that section 1211 shall not apply;

"(b) Definition of property used in the trade or business --

For purposes of this section --

"(1) General rule - The term 'property used in the trade or business' means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not --





"(A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year,

"(B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or . . . . "

Section 1698 California Civil Code:

"(Written contracts, how modified) A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise.

(Enacted 1872; Am. Code Amdts. 1873-74, p. 243). "

Section 1639 California Civil Code:

"Interpretation of written contracts. When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible; subject, however, to the other provisions of this title. (Enacted 1872). "

Section 1638 California Civil Code:

"The language of a contract is to govern its interpretation, if the language is clear and explicit and does not involve an absurdity. "

Section 1856 California Code of Civil Procedure:

"§1856. An agreement reduced to writing deemed the whole: (When evidence of other terms admitted; Certain evidence not excluded; Application to deeds and wills). When the terms of an agreement have been reduced to



writing by the parties, it is to be considered as containing all those terms, and therefore there can be between the parties and their representatives, or successors in interest, no evidence of the terms of the agreement other than the contents of the writing, except in the following cases:

"1. Where a mistake or imperfection of the writing is put in issue by the pleadings;

"2. Where the validity of the agreement is the fact in dispute.

"But this section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as defined in Section 1860, or to explain an extrinsic ambiguity, or to establish illegality or fraud. The term agreement includes deeds and wills, as well as contracts between parties. "

## QUESTIONS PRESENTED

### I

Was the sale of Clock Restaurants made to Robert O. Peterson by the petitioner, Forest G. Smith, Jr. during the calendar year 1956 ?

### II

Did Robert O. Peterson agree to assume the liabilities of





Forest G. Smith, Jr. or merely agree to purchase the assets of Clock Restaurants "subject to" Smith's debts?

### III

Did the agreement of Robert O. Peterson to take the assets of Clock Restaurants "subject to" the liabilities of Forest G. Smith, Jr. in the amount of \$603,687.96 amount to the receipt of money in that sum by Smith during the calendar year 1956 under the provisions of §1001(b) of the Internal Revenue Code of 1954?

### IV

Did the Tax Court err in deciding that there were deficiencies of \$53,359.65, \$5,952.10 and \$17,214.61 in the petitioner's Federal income taxes for the calendar years 1954, 1955 and 1956, respectively, instead of overpayments for said years in the amounts of \$15,000.00, \$4,673.34 and \$1,645.43?

### STATEMENT

Taxpayers filed income tax returns for the calendar years 1954, 1955 and 1956 with the District Director of Internal Revenue at Los Angeles, California, in which payments of tax for said years were reported in the respective amounts of \$15,000.00, \$4,673.34 and \$1,645.43 (R. 46, 64, 84; Joint Exhibits 1-A, 2-C and 3-B).

The Commissioner of Internal Revenue determined deficiencies in the petitioners' Federal income taxes for the calendar years 1954, 1955 and 1956 in the respective amounts of \$66,551.05, \$7,835.30 and \$11,479.32 (R. 12). By an amended



answer filed in the Tax Court proceeding the Commissioner asked to increase the deficiency determined for 1956 to \$17,214.61 (R. 29-31). The taxpayers petitioned the Tax Court for a redetermination of the deficiencies asserted (R. 5-20). On April 10, 1961, the petitioners, by leave of the Tax Court, filed an amendment to their petition wherein they alleged that the Commissioner erroneously failed to allow a loss carryback of at least \$187,850.14 from the calendar year 1956 to the years 1954 and 1955 (R. 25-27). Certain adjustments in petitioners' reported income were stipulated and are not now in controversy (R. 34-37, Pars. 4, 5, 6 Stip Facts). The Tax Court decided there were deficiencies of \$53,359.65, \$5,952.10 and \$17,214.61, respectively, for the years 1954, 1955 and 1956 (R. 436). The taxpayers have petitioned for a review of the Tax Court's decision by the United States Court of Appeals for the Ninth Circuit (R. 437-439).

On October 30, 1956, Forest G. Smith, Jr. and Robert O. Peterson, hereinafter referred to as Smith and Peterson, entered into a written "Memorandum Agreement", a copy of which is fully set forth in a stipulation of facts and as a finding of fact, on pages 3 to 6, inclusive, of the Tax Court's opinion (R. 420-423). On or about November 1, 1956, Peterson took possession of the assets of Clock Restaurants which were the subject of the Agreement of October 30, 1956 (R. 37).

Smith's cost basis of the assets of Clock Restaurants sold to Peterson was stipulated by the parties and found by the Tax Court to be \$290,134.40 (R. 42, Par. 20, Stip Facts; 424). None of the



assets were subject to a mortgage (Ex 6-F-1, 2; R 141) The Tax Court found the assets to be of the fair market value of \$603,687.96 on October 31, 1956 (R. 424) The parties stipulated and the Tax Court found it to be a fact that on October 31, 1956, Smith had liabilities of \$603,687.96 which pertained to the Clock Restaurants (R. 43). None of the liabilities were secured by a mortgage (R. 141).

Article (4) of the Memorandum Agreement of October 30, 1956, between Smith and Peterson was found to be a fact by the Tax Court and it provided: "Peterson hereby agrees to accept all of the above and foregoing assets referred to in paragraphs (1), (2) and (3) and to pay therefor by taking them subject to the liabilities as shown and disclosed on said financial statement dated September 30, 1956, \* \* \* " (emphasis supplied; R. 421, Ex. 6-F). The Tax Court found it to be a fact that "as a part of the consideration for Smith's sale of the restaurants to Peterson, Peterson assumed these liabilities" (R. 424). The petitioners contend the record contains no competent evidence to support such a finding of fact (R. 439, 441). The Tax Court's ultimate conclusion of law was "viewing the transfer of petitioners' property subject to his debts as the substantial receipt of 'money' in the amount of such debts within the meaning of section 1001(b) of the 1954 Code, we do not find it necessary to decide whether or not the sale contract itself possessed a fair market value " (emphasis supplied; R. 434). It was the testimony of Harold B. Lloyd, an experienced appraiser, that in his opinion the rights of Forest G. Smith, Jr., under the





Memorandum Agreement of October 30, 1956, had no fair market value at any time during 1956 for the reason that no market could be found for such rights. No prudent, well adjusted person would pay anything for them (R. 16, 19, 27).

Article (6) of the Memorandum Agreement of October 30, 1956, provided:

"Peterson has analyzed the liabilities of Clock Restaurants as shown by said financial statement of September 30, 1956, and understands that there are presently outstanding approximately \$30,000.00 of checks issued by Clock Restaurants to its creditors and that no funds are in the bank account of Clock Restaurants from which said checks can be paid and that sufficient funds must be deposited in the bank account of Clock Restaurants to cover said checks forthwith. Peterson further understands that approximately \$116,000.00 of taxes will become delinquent on the 31st day of October, 1956, which taxes represent payments due the United States Government for withholding and excise taxes, and to the State of California for unemployment and sales taxes. The parties hereto mutually understand and agree that there would not be sufficient time to consummate this transaction through a bulk sales escrow in time to pay the above referred to immediately pressing obligations, and that, accordingly, in the event that Peterson advances funds in the sum of \$146,000.00 with which to pay said pressing obligations,



that Peterson will concurrently therewith be delivered the immediate possession of all of the Clock Restaurants and the assets which are the subject matter of this agreement, and that thereafter upon the written demand by Peterson a bulk sales escrow will be opened for the consummation of the transactions contemplated by this agreement, and that if the creditors of Clock Restaurants prevent the consummation of said escrow by requiring immediate payment of their respective claims, Peterson will have the right and privilege of delivering possession to Smith or to any person entitled thereto of such of the assets being transferred by Smith to Peterson under this agreement which are subject to attack by said creditors and shall be relieved of any obligations or liabilities for the payment of said creditors' claims. As to any funds advanced by Peterson for the payment of any of the creditors of Clock Restaurants, Smith agrees to reimburse Peterson upon demand for repayment of said advances.

"As to any assets hereby transferred by Smith to Peterson which are not subject to attack by Smith's creditors, Peterson shall be entitled to keep and retain the same without the payment to Smith or to the creditors of Smith or of Clock Restaurants of any sum or other consideration therefor." (R. 421, 422).

Article (9) of the Memorandum Agreement, provided:





"In the event that the bulk sales escrow hereinabove referred to is consummated and closed, Peterson agrees to indemnify Smith and hold Smith harmless from any loss or liability by reason of or arising out of the conducting of the business of Clock Restaurants by Peterson incurred subsequent to the date of the delivery of possession of said restaurants to Peterson. Until the closing of said bulk sales escrow, Peterson will operate as agent for Smith in the conducting of the business of said Clock Restaurants by Peterson, but Peterson does hereby agree to indemnify and hold Smith harmless from any loss or liability for any debts, obligations or liabilities incurred by Peterson in the operation of said restaurant business from and after the date that Peterson takes possession." (R. 423).

It has been stipulated by the parties and found as a fact by the Tax Court that Peterson took possession of the assets of Clock Restaurants on or about November 1, 1956 (423, 37).

B. D. S. Company, a limited copartnership, was formed on the 1st day of April, 1953. Joseph W. Drown, James E. Bahan, Joseph R. Bahan, Forest G. Smith, Jr. and Winifred M. Schneider were general partners, and Mary Eileen Bahan, Lillian Agnes Bahan, Pearl Ellison, R. C. A. Lubach, Jack M. Drown and Maxine M. Code, limited partners (R. 38, 39, 142-150; Ex. 7-G, Stip. Facts). In November, 1956, Smith assigned his partnership interest in B. D. S. Company to Peterson (R. 40, 246; Ex. 11-K,



Stip. Facts) On November 5, 1956, Peterson became a general partner in B. D. S. Company and Forest G. Smith was eliminated as a general partner (R. 40, 251, 252; Ex. 14-N, Stip. Facts).

On or about November 30, 1956, Robert O. Peterson wrote letters to the various creditors of Clock Restaurants in each of which letters the following statement was made (R. 285-308; Exs 20-T - 1 to 23, Stip. Facts):

"As I have previously indicated to you, I intend to purchase certain of the Clock Restaurants from Forest G. Smith, Jr. and to assume certain of his liabilities. An escrow to complete the sale will be opened in the near future and notice of sale will be recorded and published.

"Unless I notify you to the contrary, pending completion of the sale, the Clock Restaurants will be under my control and management and the following program will be follows.

"It is my understanding that so long as the above program is followed, you will not demand payment of the amounts now owing to you by Forest G. Smith, Jr. on account of the Clock Restaurants. "

A notice of an intended sale on February 25, 1957, of Clock Restaurants to Peterson by Smith was filed in the Office of the County Recorder in Los Angeles and Orange Counties, California, and published in a legal newspaper during that month (R. 412, 413).



On or about February 27, 1957, B. D. S Company mailed letters to creditors of Clock Restaurants wherein the following statement was made to each of those creditors: "The B. D. S Company, a limited partnership, now doing business as Clock Restaurants, of which the undersigned Robert O. Peterson is a general partner, has completed purchase of Clock Restaurants from Forest G. Smith, Jr. In accordance with said letter to you of November 30, 1956, above referred to, the undersigned does hereby assume the liabilities of Forest G. Smith, Jr., mentioned in said letter, and does hereby guarantee payment of the unpaid balance thereof in consideration of your agreement not to demand payment so long as payments on account of said balance are made in the manner and at the rate set forth in said letter." (R. 309-349; Exs. 20-T - 24 to 43, Stip. Facts). Said twenty letters each stated that Robert O. Peterson, as of that date, assumed the liability of Forest G. Smith, Jr. to the addressee (R. 309-349).

It was stipulated by the parties and found to be a fact by the Tax Court that \$326,443.09 of the liabilities of Smith were paid by Peterson during 1956 and \$220,271.34 of the liabilities were paid during 1957 by either Peterson or B. D. S Company (R. 43, 425).

The petitioners reported no capital gain from sale of Clock Restaurants on their 1956 income tax return but elected to treat the transaction as a deferred payment sale (R. 112). The Commissioner of Internal Revenue determined that sale of the Clock Restaurants by petitioners was a closed transaction in 1956 and that a capital gain of \$313,553.56 was thereby realized in 1956





(R. 18). The Tax Court sustained the Commissioner's determination as to said item (R. 428).

Petitioners reported the receipt of a capital gain of \$220,271.34 from the sale of Clock Restaurants to Robert O Peterson on their Federal income tax return filed for the calendar year 1957 (R. 136). No dispute exists as to the amount of gain ultimately to be realized by the taxpayers from the sale of Clock Restaurants. The question is, in what year did they realize the gain?

### SUMMARY OF ARGUMENT

Forest G. Smith's sale of Clock Restaurants to Robert O. Peterson is shown by the documentary evidence in the record to have been made in 1957 and not in 1956. The agreement of Peterson to take the assets of Clock Restaurants subject to the debts of Forest G. Smith, Jr. created no obligation on Peterson's part to pay those debts. Smith realized a gain from the sale of Clock Restaurants only at such times as Peterson had paid Smith's debts in an amount that exceeded \$290,134.10, the cost of Clock Restaurants to Smith. Until such time as his debts were actually paid by Peterson, Smith had received neither money nor other property of any fair market value from the sale of Clock Restaurants within the meaning and intent of §1001(b) of the Internal Revenue Code of 1954.



## ARGUMENT

### I

BY THE TERMS OF THE MEMORANDUM AGREEMENT BETWEEN FOREST G SMITH, JR. AND ROBERT O. PETERSON OF OCTOBER 30, 1956, PETERSON WAS IN POSSESSION OF CLOCK RESTAURANTS AS AN AGENT OF SMITH AND NOT AS THEIR OWNER DURING THE REMAINDER OF THE YEAR 1956.

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The Tax Court fully set forth the written agreement of October 30, 1954, in its findings of facts (R. 420-423). Paragraph (9) of that agreement provided: " \* \* \* Until the closing of said bulk sales escrow, Peterson will operate as agent for Smith in the conducting of the business of said Clock Restaurants by Peterson, but Peterson does hereby agree to indemnify and hold Smith harmless from any loss or liability for any debts, obligations or liabilities incurred by Peterson in the operation of said restaurant business from and after the date that Peterson takes possession". The terms of the written agreement are clear (R. 423, 389). Nevertheless, the Tax Court, after first finding as a fact that a bulk sales escrow was never opened because Peterson and his attorney decided it was unnecessary, concluded that as a matter of law no agency relationship existed between the seller and purchaser (R. 430). It then held the sale to have been completed on October 30, 1956 (R. 428). It is true the Tax Court found, that in their 1956 income tax return, the petitioners treated the sale of Clock Restaurants to Peterson as taking place as of October 30, 1956





(R. 424). The petitioners' statement in their income tax return is here contended to have been erroneous. It is in conflict with at least forty statements to the contrary made by Peterson concerning his intent as to the sale as well as with the terms of Section (9) of the Memorandum Agreement of October 30, 1956. The conflict between these statements illustrates the wisdom of the California legislature when it provided in §1698 of the California Civil Code: "A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise." It is submitted that the Tax Court's decision and the petitioners' 1956 income tax return have both come to the same erroneous legal conclusion as to the legal effect of the Memorandum Agreement of October 30, 1956.

The clear terms of Section (9) of the sales agreement provided that Peterson was to operate the restaurants as the Agent of Smith, and parol evidence was not admissible to explain the intention of the parties. Alexander v. Commissioner, 13 B. T. A. 1169. A written stipulation of facts was entered into by the taxpayers and the Commissioner. Among the stipulated facts was the following: "Forest G. Smith, Jr., one of the petitioners herein, and Robert O. Peterson, entered into an agreement bearing date October 30, 1956, a correct copy of which agreement is attached hereto and marked Joint Exhibit 6-F" (R. 37). The preamble of that stipulation provided that either party might produce other and further evidence, not inconsistent with the facts herein stipulated. The Tax Court's Rule 31 (b)(5) provides in its material part: "The Court \* \* \* will not receive evidence tending to qualify, change, or contradict any



fact properly introduced into the record by stipulation " The Supreme Court of California has said in the case of Gaines v. California Trust Company (1940), 15 Cal 2d 255, 264-265:

"The parol evidence rule, as is now universally recognized, is not a rule of evidence but is one of substantive law. \* \* \* The rule as applied to contracts is simply that as a matter of substantive law, a certain act, the act of embodying the complete terms of an agreement in writing (the 'integration'), becomes the contract of the parties. The point then is not how the agreement is to be proved, because as a matter of law the writing is the agreement. Extrinsic evidence is excluded because it cannot serve to prove what the agreement was, this being determined as a matter of law to be the writing itself. The rule comes into operation when there is a single and final memorial of the understanding of the parties. When that takes place, prior and contemporaneous negotiations, oral or written, are excluded; or, as it is sometimes said, the written memorial super-sedes these prior contemporaneous negotiations. "

(Emphasis Supplied by the Court).

It is submitted that the Tax Court's holding that the sale was complete on October 30, 1956, is erroneous for the reason that it is not supported by the facts found by the Tax Court or the evidence



from which those findings were made.

In the first place the Tax Court has fully set forth the written Memorandum Agreement of October 30, 1956, in its findings of fact. That Agreement clearly provided that Peterson was to operate Clock Restaurants as the agent of Smith, the seller. The Tax Court could not find otherwise when the Agreement was in evidence. The Agreement was drawn and to be performed in California. The rights of the parties thereunder are to be determined by the laws of California Helvering v. Stuart (1942), 63 S. Ct. 140, 144, 29 AFTR 1209, 1213; Goold v. Commissioner (1950), CA-9, 182 F.2d 573, 575, 39 AFTR 561, 563, reversing T. C. Under those laws "a contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise". §1698, California Civil Code. "When the terms of an agreement have been reduced to writing by the parties, it is to be considered as containing all those terms \* \* \* ." §1856, California Code of Civil Procedure. "The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity." §1638, California Civil Code. It was conceded by respondent's counsel at the trial and not otherwise found by the Tax Court that the language of the memorandum agreement of October 30, 1956, was clear (R. 389, 399). "When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible; \* \* \* ." Paragraph (9) of the Memorandum Agreement of October 30, 1956, made it possible to ascertain that it was the intention of the parties that





Peterson was to operate Clock Restaurants as the agent of Smith, not as the owner thereof until the closing of a contemplated bulk sales escrow. Oral evidence may not be admitted to vary or contradict a plain provision of the Memorandum Agreement of October 30, 1956, that Peterson was the agent of Smith, not the owner of Clock Restaurants, until the closing of a contemplated bulk sales escrow. Keeler v. Murphy (1931), 117 Cal. App. 386.

There is no evidence in the record nor any finding by the Tax Court that the clear terms of the Memorandum Agreement of October 30, 1956, were at any time altered by a contract in writing. There is some evidence from which an inference could be drawn that the provisions of Section (9) of that Agreement were altered by an executed oral agreement in the year 1957. The facts found by the Tax Court will support such an inference but will not, in view of the statutory law of California with respect to the interpretation of written agreements, support one that Peterson was the owner rather than Smith's agent in the operation of Clock Restaurants at any time during the calendar year 1956. The plain terms of the written contract declare him to have been an agent. The following are facts indicating that his agency may have ripened into an ownership no earlier than the year 1957 through an executed oral contract which altered the provisions of Section (9) of the Agreement of October 30, 1956.

In each of twenty-three separate letters, each addressed to a different creditor of Clock Restaurants and dated either November 29 or 30, 1956 (a month after the Memorandum Agreement of



October 30, 1956), Robert O. Peterson stated. "As I have previously indicated to you, I intend to purchase certain of the Clock Restaurants from Forest G. Smith, Jr., and to assume certain of his liabilities. An escrow to complete the sale will be opened in the near future and notice of sale will be recorded and published." (R. 42, 285-307). That statement is consistent with the clear provision of Section (9) of the Agreement that Peterson was the agent of Smith rather than owner of Clock Restaurants on November 30, 1956.

On February 7, 1957, a notice of the intended sale of Clock Restaurants to B. D. S. Company and Peterson was filed in the Office of the County Recorder of Los Angeles and Orange Counties, California and published in a legal newspaper during the month of February, 1957, by Peterson (R. 44, 45, 412, 413). This notice recited in part:

"That Forest G. Smith, Jr., vendor, whose address is 14000 East Telegraph Road in the City of Whittier, County of Los Angeles, State of California, intends to sell to B. D. S. Company, a limited partnership, and Robert O. Peterson, vendees, \* \* \* .

All stock in trade, fixtures, equipment of a certain restaurant business known as Clock No. \* \* \* and that a sale, transfer and assignment of the same will be made, and the consideration therefor will be paid at 10:00 A. M., on the 25th day of February, 1957, at the office of Trippet, Yoakum, Stearns &





The notice of sale was signed by B. D. S. Company, by Robert O. Peterson, General Partner and Robert O. Peterson. This notice of sale is consistent with the clear provisions of Section (9) of the Memorandum Agreement of October 30, 1956, to the effect that Peterson was the agent of Smith rather than the owner of Clock Restaurants as late as February 7, 1957.

On February 27, 1957, B. D. S. Company, by Robert O. Peterson, a general partner therein, addressed twenty letters, each to a different creditor of Clock Restaurants, and in each letter the following statement was made:

" \* \* \* The B. D. S. Company, a limited partnership, now doing business as Clock Restaurants, of which the undersigned Robert O. Peterson is a general partner, has completed purchase of Clock Restaurants from Forest G. Smith, Jr. In accordance with said letter to you of November 30, 1956, above referred to, the undersigned does hereby assume the liabilities of Forest G. Smith, Jr., mentioned in said letter, and does hereby guarantee payment of the unpaid balance thereof in consideration of your agreement not to demand payment so long as payments on account of said balance are made in the manner and at the rate set forth in said letter. \* \* \* " (R. 311-349)

This statement in the letters to creditors is consistent with



the clear provision of Section (9) of the Memorandum Agreement of October 30, 1956, that Peterson was the agent of Smith rather than the owner of Clock Restaurants. It also supports the inference that the sale of Clock Restaurants was made by Smith on February 25, 1957, and that on that date Peterson's agency ripened into ownership when the statements in the notice of sale of February 7, 1957 are also considered.

Robert O. Peterson, one of the parties to the Agreement of October 30, 1956, testified that a bulk sales escrow was never opened because it was the opinion of himself, his partners and their counsel that there was no need for one (R. 395). Robert B. Ballantyne, counsel for Peterson and his partners in the transaction and a witness called on behalf of the respondent testified that no bulk sales escrow was ever opened for the reason that after Peterson had been in possession of the restaurants and had operated them for several months it was felt that an escrow was of no importance and not necessary (R. 406). The witness, Ballantyne, further testified that he attended to the matter of having a notice of sale published in February, 1957, for the purpose of finding out if there were any creditors or others that he and his client did not know about. A few claims were uncovered as a result of the publication (R. 407). This testimony is all compatible with the clear terms of Section (9) of the Memorandum Agreement of October 30, 1956, that until a bulk sales escrow was opened and closed Peterson operated Clock Restaurants as the agent of Smith and not as their owner. Until the contemplated escrow was closed the



Memorandum Agreement was an executory sales contract. There is not a scintilla of evidence that the terms of the written Memorandum Agreement were ever altered by a contract in writing. The evidence might support an inference that the provisions of Section (9) were altered by an executed oral agreement between the parties on or about February 25, 1957, and that on that date the sale of Clock Restaurants was consummated and Peterson was metamorphosed from operator as the agent of Smith to owner of the restaurants without the formality of a bulk sales escrow called for in the Agreement of October 30, 1956. It would follow however that there was no sale of Clock Restaurants to Peterson by Smith during the calendar year 1956.

It is submitted that the Tax Court erred in holding that the sale of Clock Restaurants by Forest G. Smith, Jr., to Robert O. Peterson was a closed and completed transaction in the calendar year 1956.

## II

ROBERT O. PETERSON MERELY AGREED  
TO PURCHASE THE ASSETS OF CLOCK  
RESTAURANTS SUBJECT TO THE DEBTS OF  
FOREST G. SMITH, JR.

---

If the Tax Court was wrong in its conclusion that the sale of Clock Restaurants took place in 1956, it makes no difference in the present case whether Peterson assumed Smith's debts or merely took the assets of Clock Restaurants subject to those debts. It has





been stipulated by the parties and found by the Tax Court that Peterson did pay \$326,443.08 of the debts during 1956 and \$220,271.34 in 1957. The controversy concerns the question of whether the payment of \$220,271.34 of Smith's debts by Peterson in 1957 was a gain realized by petitioners in that year as reported on their income tax return for that year or a gain realized in 1956 as determined by the Commissioner and the Tax Court. The Tax Court's decision on this point rests primarily upon its finding as a fact that as part of the consideration for Smith's sale of the restaurants to Peterson, Peterson assumed Smith's liabilities in the calendar year 1956 (R. 424).

The secondary question of whether the assumption, if it did occur, would of itself possess any fair market value is also present. It is, of course, elementary law that upon review a finding of fact of the Tax Court will be affirmed if the record contains any evidence to support the finding. Here the Tax Court had the Memorandum Agreement of October 30, 1956, respecting the sale of Clock Restaurants before it and fully set it forth in the findings of fact. That Agreement was clear (R. 420-423, 389, 399) and contained the following clause "Peterson hereby agrees to accept all of the above and foregoing assets referred to in paragraphs (1), (2) and (3) and to pay therefor by taking them subject to the liabilities as shown and disclosed on said financial statement dated September 30, 1956, \* \* \* ". "The words 'subject to' normally connote in legal parlance an absence of personal obligation." Helvering v. Southwest Consolidated Corporation (1942),



62 S. Ct. 546, 551, 28 AFTR 573, 578; Andrews v. Robertson (1918), 177 Cal. 434, 439. The Agreement of October 30, 1956, is clear and upon the authorities set forth in the preceding pages of this brief the Tax Court was not at liberty to accept parol evidence to vary the terms of that Agreement. It could only be altered by a contract in writing or by an executed oral agreement. There is no evidence in the record that the agreement to pay for the assets by taking them subject to the liabilities was ever altered by an agreement in writing. The fact that Robert O. Peterson, the purchaser, did, on February 27, 1957, advise some twenty of Smith's creditors that he did, on that date and by a specific letter, thereby assume Smith's debts to them, might support a conclusion that on that date the written agreement to take "subject to" was altered by an executed oral agreement that Peterson would actually assume those debts. This did not occur before 1957 and that year was not involved in the Tax Court's decision here on review.

It is submitted that the record required a finding and conclusion that in the calendar year 1956 Robert O. Peterson merely agreed to purchase the assets of Clock Restaurants subject to the debts of Forest G. Smith but had assumed no personal liability for the payment of those debts prior to 1957.





### III

THE AGREEMENT OF ROBERT O. PETERSON TO TAKE THE ASSETS OF CLOCK RESTAURANTS, SUBJECT TO THE DEBTS OF FOREST G. SMITH, JR., DID NOT CONSTITUTE THE RECEIPT OF MONEY BUT OF PROPERTY OTHER THAN MONEY -- WHICH WAS POSSESSED OF NO FAIR MARKET VALUE -- UNDER THE PROVISIONS OF SECTION 1001(b) OF THE INTERNAL REVENUE CODE OF 1954, UNTIL SUCH TIME AS THE DEBTS OF SMITH WERE ACTUALLY PAID BY PETERSON.

---

Section 1001(b) of the Internal Revenue Code of 1954 provides that "the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received". The Senate Report dealing with the enactment of Section 1001(b) of the Internal Revenue Code of 1954 was as follows:

"(1) The general rule in subsection (b) that the amount realized from the sale or other disposition of property is the sum of money received plus the fair market value of property received is qualified by the addition of special rules relating to real property taxes subject to the special treatment under section 164(d)." Page 5056 of 1954 U. S. Code, Congressional and Administrative News.

The provisions of §1001(b) of the Internal Revenue Code of 1954 were first enacted by Congress as a part of §202 of the Revenue Act of February 24, 1919, and were subsequently re-enacted



ten times without substantial change. Section 202, Revenue Acts of 1921, 1924 and 1926, Section 111, Revenue Acts of 1928, 1932, 1934, 1936, 1938, Section 111 of the Internal Revenue Code of 1939 and finally as Section 1001(b), Internal Revenue Code of 1954. The Senate Committee said of the provisions of §202(B) of the Revenue Act of 1918 concerning the basis for determining gain or loss:

"A provision was inserted designed to establish the rule for determining capital gains in the case of exchange of property and to negative the assertion of tax in the case of certain purely paper transactions. The substance of the provision is that when property is exchanged for other property the property received shall be treated as the equivalent of cash to the amount of its fair market value \* \* \* ." (Emphasis supplied).

C. B. 1939-1 (Part 2), page 120.

The House Ways and Means Committee said while considering the Revenue Act of 1921:

"The bill (subdivision [d]) provides new and explicit rules for determining gain or loss where property is exchanged for other property. Under existing law, 'when property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any \* \* \* .' Probably no part of the present income tax



law has been productive of so much uncertainty and litigation or has more seriously interfered with those business readjustments which are peculiarly necessary under existing conditions. Under existing law the presumption is in favor of taxation. The proposed bill modifies that presumption by providing that on an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a definite and readily realizable market value; and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value.

"The preceding amendments, if adopted, will, by removing a source of grave uncertainty, not only permit business to go forward with the readjustments required by existing conditions but will also considerably increase the revenue by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges. Proper safeguards are found in subdivisions (e) and (f), which provide that where property is exchanged for other property and no gain or loss is recognized, the property received shall be treated as taking the place of the property exchanged, for the purpose of determining gain or loss and for the purpose of determining certain important deductions,





such as those for depreciation. "

C. B. 1939-1 (Part 2), pages 175, 176.

The Senate Finance Committee said of the provisions of the Revenue Act of 1921:

"Section 202 (subdivision [c]) provides new rules for those exchanges or 'trades' in which, although a technical 'gain' may be realized under the present law, the taxpayer actually realizes no cash profit.

"Under existing law 'when property is exchanged for other property, the property received in exchange shall, for the purpose of determining gain or loss, be treated as the equivalent of cash to the amount of its fair market value, if any \* \* \* .'  
Probably no part of the present income tax law has been productive of so much uncertainty or has more seriously interfered with necessary business readjustments. The existing law makes a presumption in favor of taxation. The proposed Act modifies that presumption by providing that in the case of an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value, and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value." C. B. 1939-1 (Part 2), page 188.



The wording of §202(c) of the Revenue Act of 1924 is identical with that of the first sentence of §1001(b) of the Internal Revenue Code of 1954. The House Ways and Means Committee said of that section of the 1924 Act:

"Subdivision (c) does not correspond to any provision of the existing law but embodies in the law what is the correct construction of the existing law; that is that where income is realized in the form of property, the measure of the income is the fair market value of the property at the date of its receipt." (Emphasis supplied).

C. B. 1939-1 (Part 2), page 250.

The Senate Finance Committee said of §202(c) of the Revenue Act of 1924:

"Subdivision (c) does not correspond to any provision of the existing law but embodies in the law what is and always has been the construction of the law adopted by the Department and by the Courts; that is, that where income is realized in the form of property the measure of the income is the fair market value of the property at the date of its receipt." (Emphasis supplied).

C. B. 1939-1 (Part 2), page 275.

The Tax Court concluded that:

"Viewing the transfer of petitioners' property subject to his debts as the substantial receipt of money in the amount of such debts within the meaning of Section 1001(b)





of the 1954 Code, we do not find it necessary to decide whether or not the sale contract itself possessed a fair market value. "

This conclusion ignores the intent of Congress when it enacted §1001(b) of the Internal Revenue Code of 1954 as well as the similar provisions found in the 1939 Code and eight revenue acts that preceded that Code.

What does "money" mean? The words of statutes -- including revenue acts -- should be interpreted where possible in their ordinary, every day senses. Crane v. Commissioner (1947), 67 S. Ct. 1047, 1051, 331 U.S. 1, 35 AFTR 776, 780; Old Colony R. Co. v. Commissioner (1952), 52 S. Ct. 211, 213, 10 AFTR 786, 788. The Court of Appeals is in a position to, as a matter of judicial notice, say that "money" is a word in common every day use and that an agreement to take assets subject to liabilities is not in the ordinary every day sense "money".

Bouvier's Law Dictionary (Baldwin's 1928 Edition), page 814, defines money to be "gold and silver coins. The common medium of exchange in a civilized nation". The Supreme Court of the United States said: "The word 'money' is often and properly used as applicable to media of exchange other than coin; banknotes, for example, lawfully issued and actually current at par in lieu of coin are treated as money because flowing as such through the channels of trade and commerce unquestioned." Woodruff v. Mississippi, 162 U.S. 291, 16 S Ct. 820. The Supreme Court of California defined "money" to be "the general medium of exchange



referred to in order to designate the value of a thing". Link v  
Faulkner (1864), 25 Cal. 404 The Circuit Court of Appeals for the  
Ninth Circuit held that "property includes money" in the case of  
Halliburton v. Commissioner (1935), 78 F 2d 265, 16 AFTR 368,  
reversing B. T. A. But the same Court said in the later case of  
Pillar Rock Packing Co. v. Commissioner (1937), 90 F 2d 949,  
950: "There is no basis for considering accounts receivable as  
'money'. They are properties. Insofar as the case cited is to the  
contrary we decline to follow it." In defining the "assets" of life  
insurance companies the Commissioner of Internal Revenue has  
defined the word "money", as used in §805(4) of the Internal  
Revenue Code of 1954, "to include cash, currency, bank deposits  
(including time deposits) whether or not interest bearing, share  
accounts in savings and loan associations, checks (whether or not  
certified), drafts, money orders and any other items of a similar  
nature." Reg. 1.805-5(a)(4). Webster's New Collegiate Dictionary  
defines money to be: "1. Metal, as gold, silver, or copper,  
coined or stamped, and issued as a medium of exchange \* \* \*  
4. Any form or denomination of coin or paper lawfully current as  
money; \* \* \* 5. Anything customarily used as a medium of  
exchange and measure of value, as sheep, wampum, gold dust, etc.  
6. Written or stamped promises or certificates, which pass current  
as a means of payment; paper money." It is submitted that the  
rights of Forest G. Smith, Jr., under the Memorandum Agreement  
of October 30, 1956, do not fit any known definition of the word  
"money" much less the ordinary, every day sense of the word which



the Supreme Court says must be used in construing revenue acts, Crane v. Commissioner, supra Neither does it meet the definition of "cash equivalent" which was the terms used by the Tax Court "Cash" is defined to be: "1 Money that a person actually has, including money on deposit; especially, ready money. 2. Bills, coins; currency. 3. Money, a check, etc , paid at the time of purchase: as, he paid cash for the house." "Equivalent" means "equal in value". Webster's New World Dictionary. Section 1001(b) of the Internal Revenue Code of 1954 and Treasury Regulation 1.001 - (a) both specifically provide that the amount realized from the sale of property "shall be the sum of any money received plus the fair market value of the property other than money received". They do not permit resort to a "cash equivalent by the Tax Court as a substitute for fair market value". The wording of the statute is clear and leaves no room for interpretation.

Forest G. Smith, Jr. , received the promise of Robert O Peterson, to take the assets of Clock Restaurants subject to the debts of Smith and that is all he ever received until such times as Smith paid those debts and Smith's creditors had cancelled his obligations. Even then Peterson could return the assets and require Smith to repay any moneys advanced to the latter's creditors This arrangement placed no cash or its equivalent in Smith's hands. Until the debts had been paid, Smith was fully obligated to pay them. He was not until then released from those debts. He was not until then discharged from those debts. He had not until then





in any sense received money in any form, directly or indirectly, from the sale of Clock Restaurants. He had not until then received any property other than money that he could hope to find a buyer for under any circumstances. To ask the question, "what fully informed buyer could be found who would pay anything for Peterson's agreement to take the assets of Clock Restaurants subject to Smith's debts?" is to answer it. The Tax Court sought to avoid finding an answer to this question by saying that the promise was the equivalent of cash. That procedure simply ignores all the known definitions of the words "money" and "cash". It also ignores the applicable provisions of the Internal Revenue Code.

The testimony of Harold B. Lloyd, a witness called by the taxpayers, an appraiser with thirty years of experience and twenty-five years of service with the Internal Revenue Department as an appraiser and liquidator of assets which were subject to government liens, testified that in his opinion the rights of Forest G. Smith under the Agreement of October 30, 1956, Exhibit 6-F, had no fair market value at any time during the calendar year 1956 (R. 377, 370). His reason for the conclusion that Smith's rights had no fair market value was that he could conceive of no prudent and well adjusted individual paying money for such a contract. It had no discernible market (R. 378). The record contains no testimony or other evidence that Smith's rights under the Contract of October 30, 1956, did have any fair market value. It is submitted that the Tax Court was not relieved of the duty imposed by §1001(b) of the Internal Revenue Code of 1954 to find the fair market



value, or lack thereof, of Smith's rights under the Contract of October 30, 1956, without specifically finding that he did receive money in the amount of \$603,687.96 in 1956 under that Contract. The Tax Court was only permitted by that section of the Internal Revenue Code to determine that Smith received money or that he had received the "equivalent of cash" to the amount of the fair market value of property other than money received. It could resort to the "cash equivalent only in case no money was received and then it first had to determine what the fair market value of the property received was in order to arrive at the measure of the equivalent". The evidence in the record is that no money was received beyond the payments of \$326,443.08 made on Smith's debts in 1956 by Peterson and the "equivalent" to be related to cash was nil because there was no market for the equivalent; it had no fair market value.

No argument is advanced by the taxpayers that any of the gain realized from the sale of Clock Restaurants by Forest G. Smith was exempt from taxation. Their contention is that the gain was realized only when Peterson had paid Smith's creditors and released Smith from any and all obligation to reimburse Peterson for the payments made to those creditors. Douglas v. Willicuts (1935), 296 U.S. 1, 56 S.Ct. 59, 16 AFTR 970; Old Colony Trust Co. v. Commissioner (1929), 49 S.Ct. 499, 7 AFTR 8875; U.S. v. Boston & M. R.R. (1929), 49 S.Ct. 505, 7 AFTR 8881. The controlling principle is that income applied on a debt is constructively received. Sowell v. Commissioner (1962), CA-5, 302 F.2d 177,





9 AFTR 2d 1347    Until payment, Smith's obligation had not been reduced.    Until then he was obligated to Peterson in the same amount that he owed the creditors whose claims had been satisfied.    Until then he had realized no gain on the sale of Clock Restaurants within the intent of §1001(b) of the Internal Revenue Code of 1954.    Until then he had merely traded creditors as that term was expressed in the case, Commissioner of Internal Revenue v. North Shore Bus Co., Inc. (1944), CCA-2, 143 F.2d 114, 32 AFTR 931; not until then were the fruits of Forest G. Smith's gain on the sale of Clock Restaurants available for the payment of the income tax on that gain.    At that time the gain was taxable.    See Easson v. Commissioner (1960), 33 T.C. 963, 970, footnote 8, reversed CA-9, 249 F.2d 653, 8 AFTR 2d 5448, wherein this Circuit Court said: " \* \* \* Section 112(k) provides, clearly, that an assumption of liability is not the payment of 'other property or money', and to hold that such assumption constitutes a cash payment is a clear contradiction of the words of the statute. \* \* \* It is our belief that the purpose of the tax laws will best be served by not assessing a tax against a taxpayer until he realized his gain in a transaction in which, realistically speaking, he actually changes his position. \* \* \* " Forest G. Smith, Jr. 's position with respect to his creditors changed only when those creditors were paid.    Until then none of them released him from his personal obligation to pay his debts.

The Sixteenth Amendment authorizes the taxing of income but not the taxing of the intangible and non-negotiable contingencies



of a taxpayer on the cash receipt basis, that may in a later year result in income D D Oil Company v. Commissioner (1945), CCA-5, 117 F.2d 936, 33 AFTR 755. That aptly describes the rights Forest G. Smith, Jr., had under his contract for the sale of Clock Restaurants during the calendar year 1956. Those rights of Smith were intangible and non-negotiable contingencies

Nor do those rights fit any definition of "money" that can even be inferred from the opinion of the Supreme Court in the case of Crane v. Commissioner, 331 U.S. 1. The Tax Court does not quote the Supreme Court in the Crane case when it says in its conclusions of law: "The agreement of one to discharge the personal obligation of a taxpayer for a valid consideration is tantamount to the receipt of cash by the taxpayer in the amount of such obligation and this is so even though the discharge of the obligation is effected only by the transfer of the taxpayer's property subject to his debts Crane v. Commissioner, 331 U.S. 1." What the Supreme Court actually said on that question goes more to support the contention advanced by the petitioners in this review than the conclusion reached by the Tax Court. The Court of Appeals for the Third Circuit observed, accurately, in the case of Simon v. Commissioner (1960), 6 AFTR 2d 6077, 6080, 285 F.2d 422, affirming 32 T.C. 935, "The Court in Crane was faced solely with the question of determining the adjusted basis of real estate." There is no dispute in the pending case concerning the adjusted basis of Clock Restaurants. That has been stipulated to be \$290,134.40 and so found by the Tax Court. The Supreme Court



said in the course of its opinion in the Crane case that it was not "strictly speaking" concerned with the question of whether the vendor was in receipt of money or property but that the crux of the case really was whether the law permitted her to exclude allowable deductions (for depreciation on an apartment building) from consideration in computing gain (67 S. Ct. 1055, 35 AFTR 784). This is very different from holding that the vendor of Clock Restaurants was in receipt of money in a sum equal to the debts of that business, which were precisely equal to the value of the assets, when the purchaser agreed to take the assets subject to the liabilities. The taxpayer in the Crane case was at no time personally liable for any part of the mortgage debt in question. Here the taxpayers, and they alone, were liable for the debts of Smith until Peterson agreed with the creditors on February 27, 1957, to assume and pay those debts.

The Supreme Court said in the Crane case (67 S. Ct. 1054, 1055, 35 AFTR 783, 784): " \* \* \* As for the second, we think that a mortgagor, not personally liable on the debt, who sells the property subject to the mortgage and for additional consideration, realizes a benefit in the amount of the mortgage as well as the boot. \* \* \* 37/." (Emphasis supplied). The appended footnote reads: "Obviously, if the value of the property is less than the amount of the mortgage, a mortgagor who is not personally liable cannot realize a benefit equal to the mortgage. Consequently a different problem might be encountered where a mortgagor abandoned the property or transferred it subject to the mortgage





without receiving boot That is not this case " The record is clear that Forest G. Smith, Jr. received no boot in the transaction with Robert O. Peterson As of the end of 1956 Smith, and he alone, was still liable for such of his debts as had not been paid. Where did he benefit in any amount above the debts actually paid?

The "boot" was paid in cash to the vendor in the Crane case. Neither Forest G. Smith, Jr. nor any assignee of his, could ever get any cash -- Smith's creditors or their assignees might get cash if Peterson chose to pay them rather than to exercise his option to return Clock Restaurants to Smith and demand repayment of any sums advanced to creditors of the business in 1956. The Crane case gives no support to the Tax Court's conclusion that Smith was in the receipt of an equivalent of cash at any time before the debts of Smith were actually paid by Peterson.

The Supreme Court decided the Crane case in 1947. Congress and its committees had, for nearly thirty years previous to that time, been saying in successive revenue acts and in §111(b) of the Internal Revenue Code of 1939 that the amount realized from the sale of property shall be the sum of money received plus the fair market value of the property (other than money) received. Congress enacted §1001(b) of the Internal Revenue Code of 1954 which provides "the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received". The Commissioner's own Regulation No. 1.1001-1(a) under the 1954 Code contains the same provisions.



It is submitted the decision of the Supreme Court in the Crane case was not concerned with the amount realized on the sale of property but with the basis for computation of gain and does not conflict in any way with the expressed intent of Congress.

It is further submitted that the Agreement of Robert O. Peterson to take the assets of Clock Restaurants subject to the debts of Forest G. Smith, Jr., did not constitute the receipt of money by Smith under the provisions of §1001(b) of the Internal Revenue Code of 1954, until such time as the debts of Smith were actually paid by Peterson.

#### IV.

THE TAX COURT ERRED IN DECIDING THAT  
THERE WERE DEFICIENCIES IN THE PETI-  
TIONERS' REPORTED INCOME TAXES FOR  
THE CALENDAR YEARS 1954, 1955 AND 1956  
INSTEAD OF OVERPAYMENTS OF THOSE  
TAXES IN SAID YEARS.

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If the foregoing contentions of the petitioners are sustained, it will follow, as a matter of computation, that there were overpayments rather than deficiencies in the years involved.





## CONCLUSION

It is respectfully submitted that the decision of the Tax Court should be reversed and the matter remanded to it with directions to redetermine petitioners' Federal income taxes for the calendar years 1954, 1955 and 1956, respectively, in accordance with the opinion of the Court of Appeals for the Ninth Circuit.

Dated: May 28, 1963.

Respectfully submitted,

ERNEST R. MORTENSON

EUGENE HARPOLE

By /s/ Eugene Harpole

EUGENE HARPOLE

Attorneys for Petitioners and  
Appellants







APPENDIX "A"

EXHIBITS REQUIRED BY RULE 18(f)

<u>Exhibits</u>	<u>Page of Record For Identification</u>	<u>Page of Record For Evidence</u>
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Joint Exhibits 1-A

through 21-U

8

8

Petitioners' Exhibits

22 through 25

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WITNESSES

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Cross

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19

Robert O. Peterson

32

48

Robert B. Ballantyne

53

56





No. 18641

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**In the United States Court of Appeals  
for the Ninth Circuit**

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**FOREST G. SMITH, JR., and ROSE MARY SMITH,**  
PETITIONERS

*v.*

**COMMISSIONER OF INTERNAL REVENUE, RESPONDENT**

---

**ON PETITION FOR REVIEW OF THE DECISION OF THE TAX  
COURT OF THE UNITED STATES**

---

**BRIEF FOR THE RESPONDENT**

---

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**FILED**

**AUG - 9 1963**

**FRANK H. SCHMID, CLERK**



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## II

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**In the United States Court of Appeals  
for the Ninth Circuit**

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No. 18641

FOREST G. SMITH, JR., and ROSE MARY SMITH,  
PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

---

*ON PETITION FOR REVIEW OF THE DECISION OF THE TAX  
COURT OF THE UNITED STATES*

---

**BRIEF FOR THE RESPONDENT**

---

**OPINION BELOW**

The findings of fact and opinion of the Tax Court (R. 418-434) are not officially reported.

**JURISDICTION**

This petition for review (R. 437-439) involves federal income taxes for the taxable years 1954, 1955, and 1956. On April 29, 1960, the Commissioner of Internal Revenue mailed to the taxpayers notice of a deficiency in the total amount of \$85,865.67. (R. 12-20.) Within ninety days thereafter and on July 15, 1960, the taxpayers filed a petition with the Tax Court for a redetermination of that deficiency under

the provisions of Section 6213 of the Internal Revenue Code of 1954. (R. 5-20.) The decision of the Tax Court was entered December 13, 1962. (R. 436.) The case is brought to this Court by a petition for review filed March 11, 1963. (R. 437-439.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

#### QUESTIONS PRESENTED

1. Did the Tax Court err in finding and holding that taxpayer's sale of the Clock Restaurants took place in 1956?

2. Did the Tax Court err in finding and holding that in the sale of the Clock Restaurants in 1956 taxpayer's indebtedness pertaining to the assets sold was assumed by a solvent purchaser and that the transaction involved the substantial receipt of money and the realization of gain by taxpayer in 1956 under Section 1001 of the Internal Revenue Code of 1954?

#### STATUTES AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra*.

#### STATEMENT

In 1956, taxpayer<sup>1</sup> owned and operated the Clock Restaurants, a restaurant chain, and also was a general partner in B. D. S. Company, a California limited partnership. The B. D. S. Company held a sublessee's interest in the properties in which the Clock Restaurants were located. These subleases also cov-

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<sup>1</sup> Forest G. Smith, Jr., the husband, is referred to hereafter as the taxpayer although his wife is a party since joint income tax returns were filed for the period in issue.

ered some of the restaurant equipment. Prior to 1956, B. D. S. had, in turn, subleased the same premises and equipment to taxpayer, and this sublease was still in effect on October 30, 1956. (R. 419.)

On October 30, 1956, taxpayer and Robert O. Peterson entered into a "Memorandum Agreement" under which taxpayer sold to Peterson the Clock Restaurants and Taxpayer's interest in B. D. S. (hereafter referred to collectively as the Clock Restaurants). (R. 37, 139, 419.) The Memorandum Agreement states with respect to the terms of the sale (R. 420-421, 423):

(1) Smith does hereby sell, assign and set over to Peterson all of the assets as disclosed by said financial statement with the exception of Exceptions No. 1 and No. 2 [Exception No. 1 refers to an asset designated on the financial statement as "Contracts receivable—B. D. S. Company" in the amount of \$333,500 and Exception No. 2 refers to an asset designated as "Accounts receivable—B. D. S. Company re fixed asset acquisition" in the amount of \$20,-802.16.] Smith does hereby sell, assign and transfer to Peterson all of Smith's right, title and interest, and capital account as a general partner, in and to that certain limited partnership known and designated as B. D. S. Company, subject only to the consent of the general and special partners of said limited partnership to the substitution of Peterson as a general partner in the place and stead of Smith.

(2) Smith does hereby sell, assign, transfer and set over to Peterson all of Smith's right, title and interest as sublessee in and to the

master sublease referred to in the premises on condition that Peterson assume all of the obligations of the master sublessee as therein provided, and on the further condition that the master sublessor consents to said assignment and also on the further condition that Smith be relieved of all obligations and liabilities under said master lease which may hereafter accrue.

(3) Smith does hereby sell, transfer and set over to Peterson all of Smith's right, title, and interest in and to Clock Restaurants Nos. 17, 18, and 19.

(4) Peterson hereby agrees to accept all of the above and foregoing assets referred to in paragraphs (1), (2), and (3) and to pay therefor by taking them subject to the liabilities as shown and disclosed on said financial statement dated September 30, 1956, in the amount of \$890,450.17, exclusive of the item designated therein as "Accrued rent payable—B. D. S. Company" in the amount of \$305,481.17, thereby reducing the liabilities to \$584,969.00, plus liabilities and assets that have been accrued in the normal course of business in the operation of Clock Restaurants by Smith from and after the date of said financial statement to the date that Peterson takes possession of said Clock Restaurants.

(5) Smith does hereby indemnify and save Peterson harmless from any loss or liability by reason of any liabilities of Smith other than those shown and set forth in said financial statement of September 30, 1956, and those incurred in the normal course of the operation of said business from and after the date of said financial statement to the date that Peterson takes



possession of said Clock Restaurants. Any assets acquired and retained by Clock Restaurants from the date of said financial statement of September 30, 1956, to the date that Peterson takes possession of said Clock Restaurants are hereby likewise transferred, assigned and set over to Peterson.

\* \* \* \* \*

(10) The parties hereto mutually agree that the transfer of the interest of Smith as a general partner in B. D. S. Company to Peterson shall be deemed and considered as transferred subsequent to the acknowledgment by B. D. S. Company of the receipt from Clock Restaurants of the rental of \$305,481.17.

The agreement also states that there were certain pressing obligations of Clock Restaurants, for payment of which it was considered necessary that substantial deposits be made in the bank account of Clock Restaurants. The parties agreed that if Peterson advanced \$146,000 for payment of the pressing obligations, taxpayer immediately would deliver possession of the Clock Restaurants. They further agreed upon arrangements for the opening thereafter of a bulk sales escrow for the consummation of the transactions contemplated by the agreement upon written demand by Peterson.<sup>2</sup> On or about November 1, 1956,

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<sup>2</sup> With respect to arrangements for immediate cash advances and the proposed bulk sales escrow, the agreement states (R. 421-423) :

“(6) Peterson has analyzed the liabilities of Clock Restaurants as shown by said financial statement of September 30, 1956, and understands that there are presently outstanding approximately \$30,000.00 of checks issued by Clock Restaurants



Peterson took possession of the Clock Restaurants which were the subject of the above agreement. (R. 37, 392-393, 423.)

to its creditors and that no funds are in the bank account of Clock Restaurants from which said checks can be paid and that sufficient funds must be deposited in the bank account of Clock Restaurants to cover said checks forthwith. Peterson further understands that approximately \$116,000.00 of taxes will become delinquent on the 31st day of October, 1956, which taxes represent payments due the United States Government for withholding and excise taxes, and to the State of California for unemployment and sales taxes. The parties hereto mutually understand and agree that there would not be sufficient time to consummate this transaction through a bulk sales escrow in time to pay the above referred to immediately pressing obligations, and that, accordingly, in the event that Peterson advances funds in the sum of \$146,000.00 with which to pay said pressing obligations, that Peterson will concurrently therewith be delivered the immediate possession of all of the Clock Restaurants and the assets which are the subject matter of this agreement, and that thereafter upon the written demand by Peterson a bulk sales escrow will be opened for the consummation of the transactions contemplated by this agreement, and that if the creditors of Clock Restaurants prevent the consummation of said escrow by requiring immediate payment of their respective claims, Peterson will have the right and privilege of delivering possession to Smith or to any person entitled thereto of such of the assets being transferred by Smith to Peterson under this agreement which are subject to attack by said creditors and shall be relieved of any obligations or liabilities for the payment of said creditors' claims. As to any funds advanced by Peterson for the payment of any of the creditors of Clock Restaurants, Smith agrees to reimburse Peterson upon demand for repayment of said advances.

"As to any assets hereby transferred by Smith to Peterson which are not subject to attack by Smith's creditors, Peterson shall be entitled to keep and retain the same without the payment to Smith or to the creditors of Smith or of Clock Restaurants of any sum or other consideration therefor.

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Taxpayer's adjusted basis for the computation of gain upon the assets which he sold to Peterson pursuant to their agreement of October 30, 1956, was \$290,134.40. (R. 42, 424.) These same assets had a fair market value on October 31, 1956, of at least \$603,687.96 (R. 386-387, 424), the amount of taxpayer's liabilities which Peterson assumed as part of the consideration for the sale of the restaurants (R. 43, 424).

On taxpayer's 1956 federal income tax return the following statement appeared (R. 112-116, 424):

Taxpayer sold remaining 12% interest in Clock Restaurants as of 10/31/56 based on a balance sheet as of September 30, 1956. The

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“(9) In the event that the bulk sales escrow hereinabove referred to is consummated and closed, Peterson agrees to indemnify Smith and hold Smith harmless from any loss or liability by reason of or arising out of the conducting of the business of Clock Restaurants by Peterson incurred subsequent to the date of the delivery of possession of said restaurants to Peterson. Until the closing of said bulk sales escrow, Peterson will operate as agent for Smith in the conducting of the business of said Clock Restaurants by Peterson, but Peterson does hereby agree to indemnify and hold Smith harmless from any loss or liability for any debts, obligations or liabilities incurred by Peterson in the operation of said restaurant business from and after the date that Peterson takes possession.

\* \* \* \* \*

“(11) Smith hereby acknowledges receipt of the sum of \$10,500.00 paid by Peterson for deposit in the bank account of Clock Restaurants and as part of the payment required to provide funds to cover outstanding checks of approximately \$30,000.00 as referred to in paragraph (6) above, and Smith agrees that said sum of \$10,500.00 has been or will be used solely for said purpose and that as a result thereof Peterson will be required to advance only the additional sum of \$135,500.00.”

following Balance Sheet discloses all the assets and liabilities finally assumed by the purchaser. Since the taxpayer received only a non negotiable contractual obligation to pay the liabilities assumed and since no other consideration was received, the taxpayer elects to report the gain on the sale as a deferred payment sale. Income will be reported only when the amount of liabilities liquidated exceed the cost of the assets sold.

[Here there is set forth a list of assets totaling \$284,983.09 and a list of liabilities totaling \$603,687.96.]

Totals-----	\$284, 983. 09	\$603, 687. 96
		<u>284, 983. 09</u>

Excess of liabilities assumed over assets acquired-----	318, 704. 87
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As of December 31, 1956 \$142,493.39 had been paid on liabilities assumed.

On or about November 1, 1956, the taxpayer, B.D.S., and Peterson executed a document by which taxpayer assigned his interest in the "Master's Sublease" to Peterson and B. D. S. completely released the taxpayer from any further liability under that sublease. On the same date taxpayer, in writing, assigned to Peterson all of his interest in B. D. S. including his capital account in the partnership. Also on the same date the assignment was formally accepted by Peterson and formally consented to by the general and limited partners comprising B. D. S. (R. 39-40, 216-227, 245-254, 424-425.) At the execution of the October 30, 1956, sales agreement, Peterson advanced the amount of \$150,000 which was used to discharge certain of the obligations of taxpayer subject to which ownership of the Clock Restaurants was transferred. (R. 389-390, 425.)



Peterson's understanding of the terms of the October 30, 1956, sales agreement was that by this agreement he was personally assuming the taxpayer's debts referred to in the agreement. (R. 387-388, 425.) By letter mailed on or about November 30, 1956, Peterson circularized the taxpayer's creditors in an attempt to gain their consents with respect to payment of existing accounts payable referred to in the sale contract and current accounts. The letter was couched in terms of prospective sale in pursuance of the Bulk Sales Act of California. Nearly all of these letters were returned with the acceptance of their terms by the creditors by December 31, 1956. No creditor pressed for payment of his account to such an extent that Peterson, under the terms of the sales agreement, returned to the taxpayer any of the assets purchased by him under the agreement. (R. 42, 285-308, 390-392, 394-397, 425.) During 1956, Peterson paid \$326,443.08 on these debts and during 1957, \$220,271.34 was paid either by Peterson or B. D. S., to which he had sold the Clock Restaurants during that year. (R. 43, 309-349, 425.)

During the period between November 1, 1956, and December 31, 1956, the Clock Restaurants were under the exclusive control and management of Peterson. Smith had nothing whatsoever to do with the operation of the restaurants subsequent to November 1, 1956. Peterson maintained books of account for his operation of the restaurants from and after that date. Peterson received the income and paid the expenses of the restaurants during the period from November 1, 1956, through December 31, 1956. He reported

the income from the restaurants for that period on his 1956 federal income tax return. (R. 392-393, 425-426.)

Peterson was not asked to and did not in fact account to the taxpayer for his operations of the Clock Restaurants from and after November 1, 1956. Neither Peterson nor his attorney ever demanded of the taxpayer that a bulk sales escrow be opened. A bulk sales escrow was never in fact opened in connection with the taxpayer's sale of the restaurant to Peterson. Peterson and his attorney felt that there was no need for a bulk sales escrow because they thought they had discovered all the liabilities of the business and also because, after taking possession, they contacted taxpayer's creditors and the creditors indicated they would not press for immediate payment of their accounts. (R. 393-395, 405-406, 426.)

On October 30, 1956, when the agreement between the taxpayer and Peterson for the sale of the Clock Restaurants was executed, the fair market value of Peterson's assets exceeded his liabilities by approximately \$300,000-\$400,000. (R. 397-398, 426.)

Peterson's sale of the Clock Restaurants to B. D. S. was in writing effective as of January 1, 1957. The sale was made subject to any remaining balance due upon the debts of the taxpayer referred to in the October 30, 1956, sales agreement, and Peterson acknowledged that by the sales agreement he had assumed those liabilities of the taxpayer. (R. 41, 255-256, 426.) B. D. S. then by letter circularized the tax-



payer's creditors, who were referred to in the October 30, 1956, agreement, in much the same manner as had Peterson in November, 1956. In each letter B. D. S. specifically assumed the balances payable on the indebtedness. All of the creditors accepted the terms set forth in these letters. (R. 43, 309-349, 426-427.)

On his 1956 income tax return taxpayer reported income from B. D. S. for the period April 1, 1956, to October 31, 1956. The taxpayer was not credited with any income or loss from B. D. S. subsequent to October 31, 1956, and the taxpayer did not report any income or loss from B. D. S. for any period after October 31, 1956. (R. 41, 427.)

On or about July 10, 1957, the taxpayer filed with the District Director of Internal Revenue at Los Angeles an application for extension of time for filing his 1956 income tax return. In this application the taxpayer made the following statement (R. 138, 428):

It is impossible to accurately determine our taxable income, inasmuch as the selling price and terms of the sale of one of my business enterprises, made in December of 1956, are still in negotiation. We expect our attorneys to settle all details in the next 90 days.

On his 1957 income tax return, taxpayer stated that he sold the Clock Restaurants in 1956. On that return, the following schedule appears (R. 136, 428):

Sale of Clock Restaurants as reported in 1956 Return as a deferred payment sale

<i>Description</i>	<i>Acquired</i>	<i>Sold</i>	<i>Selling price</i>	<i>Cost or Depre- basis ciation</i>	<i>Gain (loss)</i>
Paid in 1957-----	1952	1956	\$220, 271. 34	----	----
					\$220, 271. 34

The sale by the taxpayer of the Clock Restaurants to Peterson was a closed and completed transaction in the calender year 1956. (R. 428.)<sup>3</sup>

The Commissioner assessed deficiencies in income tax against the taxpayer in the total amount of \$85,865.67 (\$66,551.05 for 1954, \$7,835.30 for 1955, and \$11,479.32 for 1956). By amendment to his answer in the deficiency proceedings in the Tax Court the Commissioner claimed an additional \$5,735.29 in tax for 1956. (R. 418.) In the deficiency proceedings all issues were settled by stipulation except the question whether the taxpayer's gain from the sale of the Clock Restaurant is taxable in 1956. (R. 419.) The Tax Court held that taxpayer's sale of the restaurants was completed on October 30, 1956. (R. 432.) The Tax Court further held that the transaction in issue involved the substantial receipt of money by taxpayer and therefore that taxpayer realized gain in 1956 under Section 1001 of the Internal Revenue Code of 1954. (R. 434.)

#### SUMMARY OF ARGUMENT

On October 30, 1956, taxpayer owned the Clock Restaurants property, consisting of a chain of restaurants

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<sup>3</sup> The books and records of the taxpayer, insofar as they pertain to the businesses operated by the taxpayer, including the operation of the Clock Restaurants which were the subject of the agreement of October 30, 1956, were kept on an accrual method of accounting, and the income or loss from these businesses is also reported on an accrual method of accounting. Nonbusiness items of income and deductions are reported by the taxpayer on the cash basis of accounting. Taxpayer's books and records pertaining to nonbusiness items of income and deductions were kept on the cash method of accounting. (R. 38, 427-428.)

and an interest in a limited partnership called the B. D. S. Company. On October 31, 1956, the Clock Restaurants property had an adjusted cost basis to taxpayer of \$290,134.40 and taxpayer had liabilities of \$603,687.96, which pertained to this property. The fair market value of the property was at least the amount of these liabilities, \$603,687.96. Taxpayer sold the Clock Restaurants property to Robert O. Peterson pursuant to a memorandum agreement dated October 30, 1956, under which Peterson took the Clock Restaurants property subject to the applicable liabilities and thus made no direct cash payment to taxpayer but effectively relieved taxpayer of his substantial liabilities. It is undisputed that taxpayer realized substantial gain from this sale transaction. The only dispute is whether this gain was realized in 1956, in accordance with the Commissioner's determination which the Tax Court sustained, or in 1957 and later periods, as the taxpayer now contends.

The position of the Commissioner, sustained by the Tax Court, is that the sale transaction took place in 1956. The record shows that the terms of the memorandum agreement provide for a present sale in 1956; the parties intended that the sale take place in that year; and the actions of both parties with respect to the conduct of the business, treatment of their rights and obligations, and reporting of their income demonstrate that the sale was completed in 1956. The Tax Court's finding on this question is amply supported by the evidence and it is not clearly erroneous. Taxpayer's factual contention that his sale of the Clock Restaurants to Peterson was made



in 1957 or later is contrary to the findings of the Tax Court and the evidence in this case. There is no basis for a claim to deferral of tax on the ground that the sale did not take place in 1956.

Under Section 1001 of the Internal Revenue Code of 1954, gain from the sale of property is the "excess of the amount realized therefrom over the adjusted basis" and the amount realized is "the sum of any money received plus the fair market value of the property (other than money) received." The Tax Court held that taxpayer in substance received "money" in the amount of his indebtedness in 1956, and that therefore he is taxable in 1956 on the full amount of his gain from the sale of the Clock Restaurants. This holding is supported by the findings and evidence that as consideration for the Clock Restaurants property Robert O. Peterson, a solvent purchaser, assumed taxpayer's debt obligation in 1956. Peterson's assumption of the liabilities is established by the terms of the memorandum agreement, Peterson's testimony, taxpayer's own tax returns, and the actions of both parties.

Taxpayer's liability for tax as the result of the assumption of his indebtedness under the circumstances of this case follows from well-established principles. The Supreme Court has held (*Crane v. Commissioner*, 331 U.S. 1) that the "amount realized" upon a taxpayer's sale of property subject to a mortgage includes the amount of the mortgage as well as any additional consideration which the selling taxpayer may receive. Therefore, even if Peterson had not personally assumed taxpayer's liabilities, taxpayer

would have realized his gain from the sale subject to liabilities in 1956, the year of sale. But the evidence in the present case shows that Peterson did personally assume the taxpayer's liabilities with respect to the Clock Restaurants property. *A fortiori*, the applicable Supreme Court decision and other pertinent authorities support the holding of the Tax Court that taxpayer in this case realized gain from the assumption of his personal obligation by Peterson in 1956.

#### ARGUMENT

##### **I. Taxpayer's sale of the Clock Restaurants to Robert O. Peterson was completed in 1956**

The Tax Court's finding that the sale of Clock Restaurants by taxpayer to Robert O. Peterson was completed in 1956 (R. 428) is supported by the terms of the contract of sale (R. 420-423). Furthermore, the evidence discussed below, concerning the intention of the parties and their interpretation of the agreement and the objective conduct of the parties, shows that the sale was completed by about November 1, 1956, and after that time the Clock Restaurants in fact were owned and operated by Robert O. Peterson and not by the taxpayer. Accordingly, there is no basis for a claim (Br. 20, 21-29) to deferral of tax on the ground that the sale did not take place in 1956.

The terms of the memorandum agreement of October 30, 1956, provide for a present sale and transfer of the Clock Restaurants. Paragraphs (1), (2), (3) of the agreement each begin with the statement that the taxpayer "does hereby sell", assign and transfer or set over to Peterson specified assets. (R. 420-421.)



The assets and liabilities which were the subject of the agreement consisted principally of the assets and liabilities disclosed on taxpayer's financial statement as of September 30, 1956 (with certain exceptions), the assets and liabilities accruing in the normal course of business from September 30, 1956, to the date Peterson took possession (about November 1, 1956), and taxpayer's interest in B. D. S. The assets and liabilities which were the subject of the contract were either ascertained or readily ascertainable on the basis of the contract description when Peterson took possession. (R. 140-141, 420-421.) The adjusted basis of the assets was \$290,134.40 and the total amount of liabilities was \$603,687.96. (R. 42-43, 424.) These stipulated amounts were reflected on taxpayer's 1956 federal income tax return. (R. 112-116, 424.) In the memorandum agreement (par. 5) the taxpayer agreed to indemnify and save Peterson harmless from any loss or liability by reason of any liabilities of taxpayer over and above those specified in the contract and totaling \$603,687.96 (R. 421). Thus the agreement contains provisions establishing the amount and identity of the assets sold and the amount and identity of the liabilities subject to which they were sold and accepted. By its terms it is an agreement for the present sale, as distinguished from the future sale, of certain assets subject to certain liabilities.

The documents executed at or about the time of the October 30, 1956, memorandum agreement further show that there was a present sale of the Clock Restaurants at that time. It is stipulated that in accordance with the memorandum agreement taxpayer

transferred his interest in the B. D. S. Company to Peterson effective November 1, 1956. (R. 41.) The Assignment of Partnership Interest is dated November 1, 1956, and states that on that date taxpayer made and Peterson accepted the assignment and the remaining partners in B. D. S. accepted Peterson as a partner in place of Smith. (R. 246-247.) In his acceptance of the assignment, Peterson stated that he "agrees to hold Forest G. Smith, Jr. [taxpayer] harmless from any loss or liability resulting from \* \* \* [taxpayer] being a partner in said limited partnership [B. D. S]." (R. 247.) On the same date as the assignment an Amendment to Certificate of Limited Partnership of B. D. S. Company was executed by the partners (including both taxpayer and Peterson), eliminating the taxpayer as a partner and substituting Peterson. (R. 251-254.) Also in accordance with the memorandum agreement of sale (R. 421, par. 2), taxpayer assigned to Peterson his interest in the master sublease under which taxpayer was operating the restaurants. The Assignment of Master Sublease states that it is effective November 1, 1956, and that Peterson assumed all of the obligations of taxpayer as master sublessee and agreed to hold taxpayer "harmless from any and all liability thereunder arising on or after the effective date hereof" and that B. D. S. released taxpayer from all obligation or liability under the master sublease on or after that date. (R. 245.)

As the documents of the sale demonstrate, the parties intended and thought they had accomplished a completed sale on or about October 30, 1956. Taxpayer's

contemporaneous view of the transaction was reflected on his 1956 federal income tax return, where he stated (R. 112, 424) :

Taxpayer sold remaining 12% interest in Clock Restaurants as of 10/31/56 based on a balance sheet as of September 30, 1956.

On his return taxpayer further stated that as consideration "taxpayer received only a non-negotiable contractual obligation to pay the liabilities assumed" and he specifically listed "all the assets and liabilities finally assumed by the purchaser." (R. 112-116, 424.) In an application for extension of time for filing his 1956 income tax return, taxpayer stated that the sale had been "made in December of 1956" but requested the delay on the ground that the "selling price and terms on the sale" required further negotiation to settle all details. (R. 138, 428.) On his 1957 income tax return taxpayer reported income from the "Sale of Clock Restaurants as reported in 1956 Return as a deferred payment sale." (R. 136, 428.) On his 1956 return taxpayer reported income of \$28,176.57 as his distributable net income from B. D. S. for the period April 1, 1956, to October 31, 1956. Taxpayer was not credited with any income or loss from B. D. S. after October 31, 1956, and he did not report any income or loss from B. D. S. for any period after that date. (R. 40-41, 111, 427.) Taxpayer did not testify before the Tax Court. Thus the evidence is that taxpayer intended to complete the sale of Clock Restaurants in 1956 and understood that by the October 30, 1956, memorandum agreement and the supplementary documents executed at or about the same time he had completed the sale.

The record supports the Tax Court's finding (R. 425-426) that during the period between November 1, 1956, and December 31, 1956, the Clock Restaurants were under the exclusive control and management of Robert O. Peterson. It is stipulated that on or about November 1, 1956, Peterson took possession of the Clock Restaurants property. (R. 37.) Peterson testified that he took control of the restaurants about November 1 and that taxpayer had nothing to do with the operation of the restaurants between that date and the end of 1956. During the last two months of 1956 Peterson received the income and reported and paid the expenses of the Clock Restaurants, he kept the books of the operation, and he was not asked to or required to account to taxpayer in any way during that period. Peterson testified that he reported the income on his 1956 tax return. (R. 393-394.) Also, Peterson's undisputed testimony establishes that at the signing of the October 30, 1956, sales agreement Peterson advanced \$150,000 to cover certain liabilities of the Clock Restaurants and at about that time taxpayer transferred the bank accounts of the business to Peterson. (R. 389-390.) During November, 1956, Peterson or his employees telephoned or in some other way contacted creditors and obtained agreements as to how the liabilities of the Clock Restaurants would be paid off. (R. 390-391.) Letters of agreement were sent out, and before the end of 1956, written agreement had been received from all but a very few creditors. (R. 285-308, 391, 425.) Effective January 1, 1957, Peterson sold the Clock Restaurants to B. D. S. (R. 255-256, 426.) The evidence thus shows that during the



last two months of 1956 Peterson conducted the Clock Restaurants business as the sole owner.

The terms of the memorandum agreement of sale and associated documents, the intention of both parties as demonstrated by documentary evidence and oral testimony, and the objective conduct of the parties with respect to the control and disposition of the Clock Restaurant's assets after October 30, 1956, all show that on or about that date taxpayer sold the Clock Restaurants to Robert O. Peterson. Nevertheless, taxpayer contends (Br. 20, 21-29) that he sold the Clock Restaurants to Peterson in 1957, or later, rather than in 1956. Taxpayer asserts (Br. 21) that the terms of the memorandum agreement of October 30, 1956, provide for a bulk sales escrow and state that, until the bulk sales escrow is closed, Peterson would operate as agent for taxpayer in the conduct of the Clock Restaurant's business. Taxpayer's argument (Br. 21-29) is that the terms of the agreement are plain and require the conclusion that Peterson was an agent and taxpayer was the owner of the Clock Restaurants throughout 1956. This argument is inconsistent with the evidence in this case and contrary to the Tax Court's findings of fact. (R. 424-428.)<sup>4</sup>

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<sup>4</sup> Taxpayer contends (Br. 21-29) that the parole evidence rule precludes consideration of any evidence other than the terms of the memorandum agreement between taxpayer and Peterson. In *Stern v. Commissioner*, 137 F. 2d 43, in rejecting this argument, the Second Circuit stated (p. 46) that "the parole evidence rule only excludes proof varying a written instrument, where the issues are between the parties to it, and does not affect the right of the Commissioner, who was not a party, to go behind the written contract in order to discover the true facts." See, also,



The memorandum agreement of October 30, 1956, does provide for the opening of a bulk sales escrow "upon the written demand by Peterson." (R. 422.) The agreement further states that "In the event that the bulk sales escrow hereinabove referred to is consummated and closed \* \* \* [Peterson agrees to indemnify taxpayer against loss or liability from Peterson's operation of the restaurants after delivery of possession to him]. Until the closing of said bulk sales escrow, Peterson will operate as agent for Smith [taxpayer] in the conducting of the business of said Clock Restaurants by Peterson [but Peterson agrees to indemnify taxpayer against loss or liability incurred by Peterson in the operation of the restaurant business after he takes possession]." (R. 423.) The Tax Court properly interpreted the provision concerning a bulk sales escrow as an option granted to the purchaser which he could exercise or not as he saw fit. (R. 429.) The provision for a bulk sales escrow was to become effective only upon Peterson's written demand (R. 422), and no such demand ever was made (R. 394, 405, 426). The first sentence of paragraph 9 of the memorandum agreement, relating to Peterson's indemnification of taxpayer expressly applies only in the event a bulk sales escrow is consummated and closed. The provision that Peterson should operate as agent for taxpayer appears in the next sentence of the same paragraph and applies "Until the closing of said bulk sales escrow". (R. 423.) The

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*Thorsness v. United States*, 260 F. 2d 341 (C. A. 6th); *Landa v. Commissioner*, 206 F. 2d 431 (C.A. D.C.); *Scofield v. Greer*, 185 F. 2d 551 (C.A. 5th).

terms and organization of the agreement thus require that the bulk sales escrow be opened on Peterson's demand before he could become taxpayer's agent until the closing of the escrow. The terms of the agreement concerning the escrow are consistent with and supplement the remainder of the agreement, discussed above, providing for a present, rather than a future, sale of the Clock Restaurants.

The only purpose of a bulk sales escrow would have been to protect Peterson against the taxpayer's creditors. As the Tax Court points out (R. 429, 431), the bulk sales statute (Civil Code, 12 West's Annotated California Codes, Sec. 3440.1) protects the creditor of a bulk seller by nullifying any sale in fraud of creditors, but the statute does not affect the finality of a bulk sale between the seller and purchaser. *Jeffery v. Volberg*, 159 Cal. App. 2d 815, 324 P. 2d 964; *Bumb v. United States*, 276 F. 2d 729 (C.A. 9th).

Moreover, taxpayer's argument with respect to the bulk sales escrow is premised upon the contention (Br. 22, 24-25) that the contract plainly provides on its face for sale later than 1956, so there can be no resort to parole evidence. On the contrary, the terms of the contract itself, discussed above, clearly support the Tax Court's determination that the sale took place in 1956. If the contract is considered less than entirely clear on its face, other available evidence conclusively establishes that the sale of Clock Restaurants occurred in 1956. The testimony of Peterson, the tax returns filed by the taxpayer, and the complete control which Peterson exercised over the Clock Restaurants after November 1, 1956, all discussed above, sup-

port the Tax Court's finding (R. 428) that the sale of Clock Restaurants was made in 1956.<sup>5</sup>

## II. Taxpayer's gain from the sale of the Clock Restaurants was realized in 1956

The further question in this case, premised upon the fact that taxpayer sold the Clock Restaurants to Peterson in 1956, is whether the taxpayer realized gain from the sale in 1956. Under Section 1001 of the 1954 Code (Appendix, *infra*), gain from the sale of property is the "excess of the amount realized therefrom over the adjusted basis" and the amount realized is "the sum of any money received plus the fair market value of the property (other than money) received." The Tax Court held (R. 433-434) that, since the purchaser, Robert O. Peterson, assumed taxpayer's obligations as the purchase price of the Clock

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<sup>5</sup> Letters to creditors of the Clock Restaurants, which were couched in terms of prospective sale, were circulated by Peterson on November 30, 1956 (R. 42, 285-308); similar letters were circulated by B. D. S. in February 1957 (R. 43, 309-349); and notices of intended sale were filed and published in February 1957 (R. 44, 45, 412, 413). Taxpayer relies upon these letters and notices as evidencing an intention by the parties that the sale take place after 1956. (Br. 25-29.) The form Notice of Intended Sale was published in February 1957 on advice of counsel to protect the purchasers against any possible unknown creditors. (R. 406-407.) The few claims uncovered by this device were in part creditors of the taxpayer in connection with other businesses of his. (R. 407.) The letters and the notices necessarily were couched in future terms, for purposes of representation to creditors, in view of the terms of Section 3440.1 (a) and (b) of the California Civil Code. These actions, and the bulk sales statute to which they relate, as pointed out above concern only the relationship between a bulk sales purchaser and the creditors of the seller and have no bearing upon the finality of the sale between the purchaser and seller.



Restaurants property, taxpayer in substance received "money" in the amount of his indebtedness in 1956 and therefore is taxable in 1956 on the full amount of his gain from the sale transaction. The correctness of the Tax Court's holding, therefore, is supported by the factual determination that Peterson assumed taxpayer's indebtedness and, further, by the principle that assumption of a taxpayer's debt by a solvent purchaser for valid consideration in a sales transaction gives rise to the realization of gain under Section 1001 of the 1954 Code.<sup>6</sup>

The purchase agreement of October 30, 1956, considered as a whole, supports the Tax Court's fact determination (R. 433-434) that it provides for the sale of the Clock Restaurants' property by taxpayer in consideration for Peterson's assumption of liability for payment of taxpayer's indebtedness with respect to that property. The agreement does state (R. 421) that Peterson agrees to accept and pay for specified assets by taking them "subject to" certain liabilities. The

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<sup>6</sup> With respect to the applicable principle see *Crane v. Commissioner*, 331 U.S. 1, discussed *infra*. The correctness of the rule may be illustrated by the example of an individual selling his residence subject to a mortgage. If the seller were able to defer reporting gain as realized until the purchaser paid off the mortgage to the third party lending institution in an amount greater than the seller's basis, often gain would not be reported until near the time the mortgage is paid off, years after the transaction really is completed. As the *Crane* opinion points out, the seller realizes a gain at the time of sale when the purchaser takes the residence or other property subject to the mortgage. The tax treatment is the same under the *Crane* decision, regardless of whether the purchaser personally assumes the mortgage, although the realization of income is even plainer than otherwise under circumstances like the present case where the purchaser assumed the seller's indebtedness.

agreement also states (R. 425, par. 5) that taxpayer agreed to indemnify and save Peterson harmless from any loss or liability by reason of any liabilities of taxpayer over and above those specified in the agreement, totaling \$603,687.96. If Peterson was assuming no personal liability for these liabilities, there would be nothing from which to hold him harmless. The agreement also states (R. 421-422, par. 6) that, under certain circumstances (involving Peterson's possible exercise of his option to demand a bulk sales escrow), Peterson should be relieved "of any obligations or liabilities for the payment of [certain creditors' claims]." Here, too, if Peterson had no personal liability there would be nothing for taxpayer to relieve him of.

In addition to the terms of the agreement itself supporting the finding of the Tax Court, additional evidence of the intention of the parties and their actions shows that Peterson assumed the liabilities in question. Peterson testified (R. 387-388) that it was his understanding that the purchase price for the Clock Restaurants was the "assumption of the amount of the liabilities" and that he "assumed the liability \* \* \* [he] was going to pay them." In accordance with this understanding, before the end of 1956 Peterson had circularized the creditors by letter and had entered into new agreements with them to discharge the indebtedness. (R. 42-43, 285-308, 425, 433.) In the agreement dated January 1, 1957, by which Peterson sold the Clock Restaurants to B. D. S., he repeatedly acknowledged that he previously had assumed the liabilities of taxpayer pertaining to the Clock



Restaurant property. (R. 255-256.) After it acquired the restaurants from Peterson, B. D. S. specifically assumed the unpaid balance owing to the various creditors. (R. 309-349.) Taxpayer himself did not testify before the Tax Court. But in his 1956 federal income tax return he expressly recognized that Peterson had assumed the liabilities as the purchase price of the Clock Restaurants property. (R. 112-116, 424.) On a balance sheet taxpayer listed "all the assets and liabilities finally assumed by the purchaser" and stated that he received a non-negotiable contractual obligation "to pay the liabilities assumed." (R. 112, 424.) He also reported the "Excess of liabilities assumed over assets acquired," though asserting that the tax should be deferred. (R. 116, 424.)<sup>7</sup>

The evidence then overwhelmingly supports the conclusion that by the purchase agreement of October 30, 1956, Peterson assumed the taxpayer's liabilities pertaining to the Clock Restaurants. It is undisputed that Peterson was solvent at the time and that the fair market value of his assets exceeded his liabilities by about \$300,000 to \$400,000. (R. 397-398, 426.) The liabilities were in fact paid and there is no contention to the contrary. (R. 43-44, 425.) Accordingly, by virtue of the October 30, 1956, purchase agreement taxpayer was effectively relieved of his indebtedness in issue by the assumption of the liabilities by a solvent purchaser of his assets. As the Tax Court points out (R. 433-434) the practical

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<sup>7</sup> At the hearing before the Tax Court taxpayer's counsel also referred to the agreement as providing that Peterson "assumes" the liabilities. (R. 361, 362.)

substance of the matter is just the same as if in return for the Clock Restaurants' assets, Peterson had agreed to pay cash to taxpayer in the amount of the specified debts and taxpayer had agreed to use such funds for the discharge of the liabilities.

Taxpayer's liability for tax as the result of the assumption of his indebtedness under such circumstances is established by *Crane v. Commissioner*, 331 U.S. 1. In the *Crane* case the taxpayer had inherited real property which was subject to a mortgage. At the date of the testator's death the property was appraised at the exact amount of the mortgage. Later, the taxpayer sold the property subject to the mortgage and received only \$2,500 in additional cash. The taxpayer never was personally liable for the mortgage and the purchaser did not assume the mortgage. Prior to the sale under an arrangement with the mortgagee taxpayer had collected the rents, paid operating expenses and taxes, and paid over the net rentals to the mortgagee, and she had claimed the appropriate deductions for interest on the mortgage and depreciation of the building. The Supreme Court held that the property which taxpayer acquired and sold was not the equity, as she claimed, but was the physical property itself undiminished by the mortgage. The basis for determining gain was the value of the property, undiminished by the mortgage, less appropriate adjustments. The Court further held that the "amount realized" on taxpayer's sale (defined under the Revenue Act of 1938, c. 289, 52 Stat. 447, Section 111(b), as under Section 1001(b) of the 1954 Code, as "the sum of any money received plus the

fair market value of the property (other than money) received”) included the amount of the mortgage assumed by the purchaser as well as the relatively small amount of cash taxpayer received. The Court stated (331 U.S. 1, 13):

\* \* \* [Taxpayer] concedes that if she had been personally liable on the mortgage and the purchaser had either paid or assumed it, the amount so paid or assumed would be considered a part of the “amount realized” within the meaning of § 111(b) [Revenue Act of 1938]. The cases so deciding have already repudiated the notion that there must be an actual receipt by the seller himself of “money” or “other property,” in their narrowest senses. It was thought to be decisive that one section of the Act must be construed so as not to defeat the intention of another or to frustrate the Act as a whole, and that the taxpayer was the “beneficiary” of the payment in “as real and substantial [a sense] as if the money had been paid it and then paid over by it to its creditors.”<sup>8</sup>

The Supreme Court further stated in *Crane* (331 U.S. 1, 14):

\* \* \* we think that a mortgagor, not personally liable on the debt, who sells the property subject to the mortgage and for additional consideration, realizes a benefit in the amount of the mortgage as well as the boot. If a purchaser pays boot, it is immaterial as to our problem whether the mortgagor is also to receive money

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<sup>8</sup> See, also, *United States v. Hendler*, 303 U.S. 564; *Bronx Hotels, Inc. v. Commissioner*, 34 B.T.A. 376; *Haass v. Commissioner*, 37 B.T.A. 948, all cited by the Supreme Court in the *Crane* opinion with respect to the quoted statement.



from the purchaser to discharge the mortgage prior to sale, or whether he is merely to transfer subject to the mortgage—it may make a difference to the purchaser and to the mortgagee, but not to the mortgagor. Or put in another way, we are no more concerned with whether the mortgagor is, strictly speaking, a debtor on the mortgage, than we are with whether the benefit to him is, strictly speaking, a receipt of money or property. We are rather concerned with the reality that an owner of property, mortgaged at a figure less than that at which the property will sell, must and will treat the conditions of the mortgage exactly as if they were his personal obligations. If he transfers subject to the mortgage, the benefit to him is as real and substantial as if the mortgage were discharged, or as if a personal debt in an equal amount had been assumed by another.

The principles of the *Crane* opinion were applied and discussed by the First Circuit in *Parker v. Delaney*, 186 F. 2d 455, certiorari denied, 341 U.S. 926. In *Parker* the taxpayer had held apartment house properties subject to mortgages, without assuming personal liability on the mortgage debts. After taxpayer had operated the property for several years during which he claimed depreciation deductions, when the mortgages were in default, by agreement the mortgagee banks took back the properties. No cash payment was involved. On the basis of the *Crane* opinion, the First Circuit held that taxpayer realized gain from the disposition of the property subject to the mortgage, even though he never had assumed personal lia-

bility for the mortgage indebtedness.<sup>9</sup> See, also, *Woodsam Associates v. Commissioner*, 198 F. 2d 357 (C.A. 2d); *Fawsett v. Commissioner*, 63 F. 2d 445 (C.A. 7th), certiorari denied, 290 U. S. 641.

The *Crane* opinion and the consistent authorities discussed above support the conclusion that taxpayer realized gain on his disposition of the Clock Restaurants in 1956 regardless of whether Peterson assumed personal liability for taxpayer's indebtedness. While the *Crane* case involved the context of a disposition of property subject to mortgage indebtedness, there is no logical distinction between that transaction and the disposition of property subject to other valid indebtedness pertaining to the assets transferred. Moreover, the conclusion that in the instant case the taxpayer realized gain within the meaning of Section

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<sup>9</sup> In *Parker v. Delaney* the First Circuit stated (186 F. 2d 455, 458):

"If the amount of the unassumed mortgage in the *Crane* case was properly included in the amount realized on the sale, the amounts of the unassumed mortgages should be held to have been realized on the disposition in this case. \* \* \* the property in the hands of appellant was relieved at the time of disposition of the mortgage liens and obligations. So far as appellant was concerned as owner these were paid even though he was not personally liable for them. The matter was so treated in the *Crane* case, 331 U.S. at page 13, 67 S. Ct. at page 1054. The added factor there, not present here, that boot was paid over and above the mortgage, is not material so long as the value of the properties was not less than the liens. Boot served to show this in the *Crane* case, but the payment of boot is of course not the only means of showing whether or not value is equal to or more than the liens on the property disposed of."



1001(b) of the 1954 Code from his sale of the Clock Restaurants in 1956 follows *a fortiori* from the *Crane* opinion. As demonstrated above, the evidence in this case amply supports the Tax Court's factual determination that in 1956 the purchaser, Peterson, assumed taxpayer's indebtedness with respect to the Clock Restaurants property. Taxpayer's realization of gain thus is demonstrated not only by the transfer of property subject to indebtedness, as in *Crane*, but also by the assumption of personal liability for the indebtedness by a solvent purchaser. Under these circumstances, the controlling authorities clearly support the Tax Court's holding that taxpayer realized gain from the assumption of his personal obligation by Peterson in 1956. *Crane v. Commissioner*, 331 U.S. 1, 13; *Parker v. Delaney*, 186 F. 2d 455, 458 (C.A. 1st).

*Easson v. Commissioner*, 294 F. 2d 653 (C.A. 9th), upon which taxpayer relies (Br. 42) does not concern the issue in the instant case. The *Easson* case involved specific provisions of the 1939 Code (Section 112) with respect to whether gain or loss is recognized when property, subject to indebtedness, is transferred to a corporation solely in exchange for stock of the corporation and the transferor satisfies requirements of control of the corporation immediately after the transfer. The opinion deals only with a specific nonrecognition problem under the 1939 Code and is based upon statutory provisions and concerns matters not involved in the present case.

Taxpayer's discussion of the legislative history of predecessors of Section 1001(b) of the 1954 Code and of various dictionary definitions of the terms "money" and "property" (Br. 32-39) contains no reason for reversal in this case. In the *Crane* case (331 U.S. 1, 13) the Supreme Court expressly rejected the argument that the term "money" and "other property" in this statute should be construed "in their narrowest senses." Taxpayer's attempted distinction of the *Crane* opinion (Br. 43-46) is without merit. In that case the Supreme Court interpreted the language of the predecessor of Section 1001, and that language is the same as the controlling statute here. In the light of the facts of this case the Supreme Court's interpretation of the applicable law in *Crane*, discussed above, supports the affirmance of the Tax Court's decision as involving an *a fortiori* situation.<sup>10</sup>

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<sup>10</sup> In view of its disposition of the case the Tax Court declined to decide whether the sale contract itself possessed a fair market value. (R. 434.) Taxpayer's argument before this Court that he obtained no rights with any fair market value in 1956 rests upon the testimony of Harold B. Lloyd. (Br. 40-41.) We note that with respect to the value of Peterson's obligation to pay taxpayer's obligations Mr. Lloyd testified that (R. 381), " \* \* \* as an appraiser of physical assets, I can't ascertain or I can't determine that value." We submit that Mr. Lloyd's testimony as a whole (R. 377-382) is confused and of little value and would not constitute a basis for considering that a personal obligation of a man (Peterson) whose net worth is \$300,000 to \$400,000 has no fair market value.

## CONCLUSION

For the foregoing reasons, it is submitted that the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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AUGUST 1963.

## CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ——— day of August 1963.

\_\_\_\_\_  
*Attorney.*

## APPENDIX

### Internal Revenue Code of 1954:

#### SEC. 1001. DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the amount realized—

(1) there shall not be taken into account any amount received as reimbursement for real property taxes which are treated under section 164(d) as imposed on the purchaser, and

(2) there shall be taken into account amounts representing real property taxes which are treated under section 164(d) as imposed on the taxpayer if such taxes are to be paid by the purchaser.

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange of property, the extent to which the gain or loss determined under this section shall be recognized for purposes of this subtitle shall be determined under section 1002.

(d) *Installment Sales.*—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment represent-



ing gain or profit in the year in which such payment is received.

(26 U.S.C. 1958 ed., Sec. 1001.)

Treasury Regulations on Income Tax (1954 Code):

SEC. 1.1001-1 *Computation of gain or loss.*

(a) *General rule.* Except as otherwise provided in subtitle A of the Code, the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained. The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property (other than money) received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. The general method of computing such gain or loss is prescribed by section 1001, which contemplates that from the amount realized upon the sale or exchange there shall be withdrawn a sum sufficient to restore the adjusted basis prescribed by section 1011 and regulations thereunder (i.e., the cost or other basis adjusted for receipts, expenditures, losses, allowances, and other items chargeable against and applicable to such cost or other basis). The amount which remains after the adjusted basis has been restored to the taxpayer constitutes the realized gain. If the amount realized upon the sale or exchange is insufficient to restore to the taxpayer the adjusted basis of the property, a loss is sustained to the extent of the difference between such adjusted basis and the amount realized. The basis may be different depending upon whether gain or loss is being computed. For example, see section 1015(a) and the regulations thereunder.

\* \* \* \* \*

(26 C.F.R., Sec. 1.1001-1.)





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FOREST G. SMITH, JR. and  
ROSE MARY SMITH,

Petitioners,

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COMMISSIONER OF INTERNAL  
REVENUE,

Respondent.

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REPLY BRIEF FOR THE PETITIONERS

---

ON PETITION  
FOR REVIEW OF DECISION OF  
THE TAX COURT OF THE UNITED STATES

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**FILED**

AUG 20 1963

FRANK H. SCHMID, CLERK

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REPLY BRIEF FOR THE PETITIONERS

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OPINION BELOW

The Opinion of the Tax Court is reproduced on pages 418-434 of the Record.

JURISDICTION

The jurisdictional matters are set forth on pages 1-4 of Petitioners' Opening Brief.

QUESTION PRESENTED

The questions presented are set forth on pages 11 and 12 of Petitioners' Opening Brief.





## STATUTES AND REGULATIONS INVOLVED

These are set forth at pages 4-11 of Petitioners Opening Brief.

### STATEMENT

Accuracy requires the statement of the second sentence on page 7 of the respondent's brief to read "These same assets had a fair market value on October 31, 1956, of at least \$603,687.96 (R. 386-387, 424), the amount of taxpayer's liabilities, subject to which Peterson accepted the restaurants (R. 421, Item 4, R. 434) and which liabilities were personally assumed by Peterson in agreements he made with Smith's creditors on or about February 27, 1957 (R. 309-349, Exs. 20-T-24 to 43)."

The final paragraph on page 10 of respondent's brief can be stated in a more informative manner. It should read "B. D. S. Company, a co-partnership formed on or about March 27, 1957, desired to acquire all of the assets of Clock Restaurants from Robert O. Peterson as of January 1, 1957 (R. 255, 257, 268-272, 412-413). To that end Robert O. Peterson and B. D. S. Company, at a time subsequent to the formation of the co-partnership on or about March 27, 1957, executed an instrument entitled 'Assignment' which the parties signed as of January 1, 1957 (R. 255-256). The Articles of Limited Partnership of B. D. S. Company were acknowledged by the partners on March 27, 1957 (R. 268-272). The Articles of Co-Partnership recited that the parties desired to



combine the assets of Robert O. Peterson, doing business as Clock Restaurants, with the assets of the limited partnership " (R. 257).

On February 27, 1957, a letter wherein Robert O. Peterson was in the opening sentence named as 'the undersigned' circularized the taxpayer's creditors. In each letter the 'undersigned' (Robert O. Peterson) specifically assumed the balances payable on the indebtedness of Smith. All of the creditors subsequently accepted the offer of Peterson as set forth in these letters (R. 43, 309-349).

It has been stipulated that Peterson's agreement and understanding of the purchase price for the assets purchased under the agreement of October 31, 1956, was that he would take the assets subject to liabilities of \$603,687.96 and it was further stipulated that neither the petitioners nor the respondent might introduce evidence of any facts inconsistent with that stipulated fact (R. 421 (4) (3), R. 33, 37 (7), R. 43 (22) ). The Tax Court excluded Peterson's testimony as to his understanding of the purchase price from evidence for the reason that the written contract itself was clear (R. 389).

### SUMMARY OF ARGUMENT

#### 1.

The Tax Court's conclusion that the sale of Clock Restaurants to Peterson was completed in 1956 is unsupported by the evidence, contrary to the facts stipulated by respondent and the





petitioners and clearly erroneous.

The agreement entered into between Forest G. Smith, Jr. and Robert O. Peterson, on October 30, 1956, was an agency agreement for the conduct of the business of Clock Restaurants accompanied by an executory sales agreement. The sales agreement, in oral form, was executed on or about February 27, 1957 when Peterson agreed to assume the debts of Smith.

## ARGUMENT

### I.

#### TAXPAYER'S SALE OF CLOCK RESTAURANTS TO ROBERT O. PETERSON WAS COMPLETED IN 1956.

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It was stipulated by the respondent and the petitioners that "Forest G. Smith, Jr., one of the petitioners herein, and Robert O. Peterson, entered into an agreement bearing date October 30, 1956, a correct copy of which agreement is attached hereto and marked Joint Exhibit 6-F." (R. 37). Exhibit 6-F is the contract involved (R. 420-423). The Tax Court fully set forth the agreement as one of its findings of fact (R. 419, 420-423). It was primarily stipulated by the respondent and the petitioners that neither of them might introduce any evidence inconsistent with the fact that Exhibit 6-F was a correct copy of the agreement between Forest G. Smith, Jr. and Robert O. Peterson of October 30, 1956 (R. 33). In effect the stipulation applies the parol evidence rule to the respondent in this case insofar as the agreement between Smith



and Peterson is concerned. Counsel for the respondent, in response to direct questions asked him by the judge of the Tax Court during the course of the trial of the action, agreed that the terms of the agreement of October 30, 1956 were clear (R. 389, 398, 399).

The respondent's brief twice alludes to the fact that the taxpayer did not testify before the Tax Court (pp. 18, 26). The only legitimate inference that can be drawn from this failure to testify is that a correct copy of the agreement which Forest G. Smith, Jr. made with Robert O. Peterson on October 30, 1956 had been introduced in evidence as a stipulated fact with a concurrent stipulation that no evidence of any inconsistent fact might be introduced.

Petitioners and their counsel relied upon the stipulation of respondent's counsel as well as Rule 31 (b)(5) of the Tax Court that no evidence tending to qualify, change or contradict any fact properly introduced into the record by stipulation might be offered. There was no reason for Smith to testify as to facts that had already been stipulated to. Actually, as will be hereafter pointed out, Peterson's testimony upon which respondent's brief so heavily leans concerned agreements that Peterson subsequently made with Smith's creditors, and not the one he made with Smith. Peterson's testimony reconciles with the stipulated terms of the agreement of October 30, 1956 (Ex. 6-F) and the rules of the Tax Court when it is considered that he was not talking about Exhibit 6-F but about Exhibits 20 T, 1-43 (R. 285-349). The Tax Court itself excluded the testimony of Peterson as to what he understood the consideration for the agreement of October 30, 1956 to be (R. 389).



By the terms of the agreement of October 30, 1956, it is clear that Smith and Peterson both recognized that the demands of Smith's creditors were so pressing that an executed sales agreement could not be worked out between them before the creditors moved in and closed the business of Clock Restaurants. Peterson was not willing to commit himself to the purchase of the restaurants at that time but was willing to advance the money to pay off the most insistent of Smith's creditors. To protect these advances he was placed in control of the restaurants as the agent of Smith and was to remain in that position until a bulk sales escrow could be closed. The Tax Court correctly found the provision concerning a bulk sales escrow to be an option granted Peterson which he could exercise or not as he saw fit (R. 429).

It is, however, submitted that the exercise of that option or its waiver was one of the conditions precedent to the termination of the agency between Smith and Peterson and not a condition subsequent to the sale of Clock Restaurants as the Tax Court concluded (R. 423 (9), 429). The possession of Clock Restaurants was initially delivered to Peterson, the buyer, on trial or approval. He signified his approval or acceptance to the seller on or about February 25, 1957, after he had the consents of Smith's creditors. At the time of his approval, title to Clock Restaurants passed to Peterson. Section 1739 (2)(a), California Civil Code.

Inasmuch as Peterson did not exercise his option to demand a bulk sales escrow and one was never opened the question of when and how the agency of Peterson created by the agreement of





October 30, 1956, was terminated arises. When did Peterson cease to be the agent of Smith in the operation of Clock Restaurants and become the owner?

In California the terms of a written agreement may be altered only by a written agreement or an executed oral agreement. Section 1698, California Civil Code. There is no evidence or any contention the agreement of October 30, 1956, was altered by a written agreement. It is admitted by all that Peterson did become the purchaser of Clock Restaurants and ceased to operate them as the agent of Smith. It necessarily follows that this changed relationship was created by an executed oral agreement. All of the evidence points to the fact that such an oral agreement was executed on or about February 25, 1957.

The best explanation of the metamorphosis is found in the testimony of respondent's witness Robert B. Ballantyne, an attorney who represented Peterson in the transaction.

"Well, I would like to say that these parties -- at least Mr. Peterson -- was relying on my advice in connection with this transaction at that time; and by the time we had the -- we were in possession of the restaurants and had operated them for several months and had contacted the sellers' creditors and found that they were not going to -- or, rather, that they would go along with the transaction, we felt that an escrow was probably, by that time, of no importance and not necessary." (R. 406).



Webster's New World Dictionary, p. 1335, defines "several" as "more than two but not many".

The foregoing testimony of the respondent's witness establishes Peterson's operation of the Clock Restaurants as the agent of Smith lasted for "several", that is more than two, months after November 1, 1956 or until some time subsequent to January 1, 1957, before he decided to forego the exercise of his option to demand a bulk sales escrow.

There is in evidence a published and recorded notice of an intention of Smith to sell Clock Restaurants to Peterson dated in February, 1957, and signed by Robert O. Peterson, which states that the sale, transfer and assignment of Clock Restaurants would be made and the consideration paid on February 25, 1957 (R. 412, 413). Before said date Peterson was advising Smith's creditors that he intended to purchase Clock Restaurants and to assume Smith's debts (R. 285-308). Two days after February 25, 1957, Peterson advised the same creditors that B. D. S. Company, of which he was a general partner, had completed the purchase of Clock Restaurants and did assume Smith's debts (R. 309-349). At that time he expressed the buyer's approval of which Section 1739 (2)(a) of the California Civil Code treats and title to Clock Restaurants passed from Forest G. Smith, Jr. to Robert O. Peterson.

The respondent misconstrues the basis of the contentions on pages 21-29 of the petitioners' opening brief. It is of course well established that the parol evidence rule only applies to the parties to a contract as the cases of Stern v. Commissioner, 137





F.2d 43; Thorsness v. United States, 260 F.2d 341, Landa v. Commissioner, 206 F.2d 431, Scofield v. Greer, 185 F.2d 551, hold. However, it is submitted that when the Commissioner has stipulated that a written document is a correct copy of the agreement of the parties and that he will offer no evidence inconsistent with that fact he has also agreed that the parol evidence rule is binding upon him with respect to the instrument and may not thereafter introduce evidence that goes behind the written contract. The true facts with respect to the terms of that contract are settled by the terms of the contract itself when the stipulation is received in evidence. Rule 31(6)(5) of the Tax Court. The contract is clear and it said Peterson was the agent of Smith.

Thus it clearly appears that the written contractual cocoon of October 30, 1956, was ruptured by an executed oral sales agreement on February 25, 1957. "The pupa emerged as a butterfly." Robert O. Peterson ceased to operate Clock Restaurants as the agent of Smith and became their owner. That was the day Smith actually sold Clock Restaurants. The statement in taxpayer's 1957 income tax return that Clock Restaurants were sold as of October 31, 1956, is at best the legal conclusion of a layman. That conclusion could be offered by neither party to vary the clear terms of the agreement of October 30, 1956 (Ex. 6-F, R. 420-423). It should be noted that the 1957 return reported a gain of \$220,271.34 from the sale of Clock Restaurants (R. 136, 428). The respondent accepted neither the 1956 nor the 1957 income tax return of the taxpayer as being correct. Otherwise the pending controversy



would never have arisen.

It is submitted that there is no evidence to support the Tax Court's conclusion that the taxpayer's sale of Clock Restaurants to Robert O. Peterson was completed in 1956.

## II.

THERE IS NOTHING IN THE RECORD TO SUPPORT THE TAX COURT'S HOLDING THAT ROBERT O. PETERSON ASSUMED TAXPAYER'S OBLIGATIONS AS THE PURCHASE PRICE OF CLOCK RESTAURANTS AT ANY TIME IN 1956.

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It was stipulated by the respondent and the taxpayer that the agreement of October 30, 1956 provides: "Peterson hereby agrees to accept all of the above and foregoing assets and to pay therefor by taking them subject to the liabilities." (R. 421, emphasis ours). It was further stipulated that neither party might introduce any evidence inconsistent with that fact (R. 33). It has already been pointed out in this brief that the same agreement provides Peterson temporarily took over the assets as the agent of Smith and not as a purchaser.

It is also a stipulated fact that on November 29 and 30, 1956, Peterson made tentative offers to at least 21 creditors to assume Smith's debts to them if those creditors would alter the terms and extend the times of payment of the debts owing them (R. 42, §21, R. 285-308, Joint Exhibits 20 T, 1-23). It was further stipulated that on February 27, 1957 Robert O. Peterson entered into a separate agreement with each of 20 of Smith's creditors to actually



assume the debt owing them by Smith (R. 43, Joint Exhibits 20 T, 24-45 found at R. 309-349). It is true that Peterson was asked what his understanding of the purchase price of the assets was by respondent's counsel and, over objection by petitioner's counsel, said "I assumed the liability I was going to pay them" (R. 389, lines 19-20). If the answer had been allowed to stand it would have been a nullity because it was inconsistent with the stipulated fact that Peterson agreed to pay for the assets by taking them subject to the liabilities (R. 421). The Tax Court sustained an objection to that evidence (R. 389).

It is submitted that the Tax Court's finding of fact that "as a part of the consideration for Smith's sale of the restaurants to Peterson, Peterson assumed these liabilities" (R. 424) is supported by no evidence that the assumption took place in 1956. The Tax Court made no finding as to the year in which Peterson assumed Smith's debts. Peterson's assumption of the liabilities in 1957 was the consideration he gave creditors in 1957 for an extension of time within which he might pay the liabilities, not a part of the consideration he gave Smith for the purchase of the assets.

Respondent's brief states it to be a fact that effective January 1, 1957, Peterson sold Clock Restaurants to B. D. S. (Br. p. 19). Respondent's brief again states "in the agreement dated January 1, 1957, by which Peterson sold the Clock Restaurants to B. D. S. , he repeatedly acknowledged that he previously had assumed the liabilities of taxpayer pertaining to the Clock





Restaurant property (R. 255-256)" (Br. p. 25). Neither statement is accurate.

Nowhere on pages 255-256 of the record is it even once stated that Peterson had assumed the liabilities of the taxpayer. It is stated on page 256 of the record that B. D. S. assumed the liabilities of Peterson. Peterson himself did not incur the liabilities until February 27, 1957 (R. 309-349). At no place in the instrument of Assignment does it state that any one had assumed any of the liabilities of Smith (R. 255-256).

In the second place other evidence in the record discloses that although the assignment found on pages 255-256 of the record is dated "as of" January 1, 1957, it was actually executed on or about March 27, 1957, at a time subsequent to February 27, 1957, when Peterson is first shown by any evidence to have assumed Smith's debts (R. 309-349). First in the chain of circumstances are "Articles of Limited Partnership of B. D. S. Company" signed "as of" January 1, 1957, but acknowledged by the parties on March 27, 1957, a month after Peterson had assumed Smith's liabilities (R. 257-271). Corroborative of the fact that the limited partnership agreement was made considerably later than January 1, 1957, is Joint Exhibit 24 (set forth in full at page 414 of the Record; R. 45). This exhibit is a copy of B. D. S. 's Certificate of Business Under Fictitious Name. It is stipulated that it was published in the Los Angeles Daily Journal on April 9 and 30, 1957 (R. 45). Section 2468 of the California Civil Code provides that the Certificate must be filed and published "within one month after the commencement



of said business, or after the formation of the partnership, or within one month from the time designated in the agreement of its members for the commencement of the partnership." The partnership agreement does not designate a time for the commencement of the partnership. It does provide that the partnership shall continue until December 31, 1966 (R. 259). It is to be presumed that the partners and their counsel were familiar with and obeyed this law of California. It follows that the business Clock Restaurants was not transferred to B.D.S. by Peterson on January 1, 1957, but occurred later than February 27, 1957.

It should be noted that the preliminary paragraphs of the said Articles of Limited Partnership recite that the parties desire to combine the assets, subject to the liabilities, of Robert O. Peterson, doing business as Clock Restaurants, with the assets of the limited partnership (R. 257). Article II, section 1 of the partnership agreement provides: "The partnership shall engage in the restaurant business under the name of Clock Restaurants." The Certificate of Business under Fictitious Name certifies that "the partnership is conducting a restaurant and drive-in business under the fictitious name of Clock Restaurants."

It is submitted that there was no evidence before the Tax Court that would support a finding that Forest G. Smith's debts were assumed by Robert O. Peterson at any time prior to 1957.

The case of Crane v. Commissioner, 331 U.S. 1, has already been discussed at length on pages 37-46 of petitioners' opening brief.





The case of Parker v. Delaney, 186 F.2d 455, cited at page 29 of respondent's brief deals with the effect of depreciation taken upon apartment houses on the taxpayer's adjusted basis for computing gain or loss when he sold the apartment houses. There is no controversy here about the amount of gain realized by the taxpayers nor of the basis for computing that gain.

In Woodsam Associates v. Commissioner, 198 F.2d 357 (p. 30, respondent's brief), also involves a dispute over the basis for computing gain or loss. That issue is not present in the pending case.

Fawsett v. Commissioner, 63 F.2d 445 (p. 30, respondent's brief), has to do with a dispute as to the year in which the taxpayer who had received cash from the sale of real estate should report it as income. It was held to be the year in which she received the cash. That is not one of the questions here presented.

It is submitted that there is no evidence that Forest G. Smith, Jr. realized or received any gain in 1956 of more than \$36,308.68, the excess of his debts (\$326,443.08) which Peterson paid in 1956 (R. 425) over the adjusted basis of Clock Restaurants (\$290,134.30) (R. 42).



CONCLUSION

It is respectfully submitted that the decision of the Tax Court should be reversed.

Dated: August 26, 1963.

Respectfully submitted,

ERNEST R. MORTENSON

EUGENE HARPOLE

By /s/ Eugene Harpole

EUGENE HARPOLE

Attorneys for Petitioners

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that in my opinion this brief is in full compliance with those rules.

/s/ Eugene Harpole

EUGENE HARPOLE



NO. 18642

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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MILES CONSTRUCTION CORP.,

*Appellant,*

*vs.*

HELEN H. DEMPSTER, *et al.*,

*Appellees.*

---

## APPELLANT'S OPENING BRIEF.

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---

## APPELLANT'S OPENING BRIEF.

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### I.

#### Jurisdiction.

This action initially was commenced in the Superior Court of the State of California, in and for the County of Los Angeles. [Tr. Vol. I, p. 42.] Defendant Miles Construction Corp. filed a Cross-Complaint naming Great American Insurance Company as a cross-defendant. [Tr. Vol. I, p. 52.] Great American Insurance Company filed a "Cross-Complaint to Quiet Title to Personal Property" naming therein the United States of America as cross-defendant, and invoking the consent of the United States to suit granted by Title 28, U. S. C. §2410. [Tr. Vol. I, p. 7 and p. 8, lines 19 and 20.] This section conferred jurisdiction upon the District Court, and also upon the State Court.

Defendant United States of America removed the action to the United States District Court, for the

Southern District of California, Central Division [Tr. Vol. I, p. 2], invoking the jurisdiction conferred by Title 28, U. S. C. §§1441, 1442, and 84(b)(2). [Tr. Vol. I, p. 4, lines 11-15.] These sections conferred jurisdiction on the District Court, and jurisdiction to hear this appeal is conferred by Title 28 U. S. C. §§41 and 1291, as this is an appeal from a final decision of the United States District Court. [Tr. Vol. I, pp. 197 and 212, *et seq.*]

## II.

### Statement of the Case.

While the pleadings are quite voluminous, the facts are to a large extent undisputed, and, with respect to the issues here, are not complicated. Chronologically, they are as follows:

On October 8, 1956, Appellant Miles Construction Corp. (hereinafter referred to as "Miles") entered into a written Agreement with A. T. Locke. [Tr. Vol. I, pp. 59-67, incl.] A. T. Locke (hereinafter referred to as "Locke") assigned a portion of his interest to John M. Sherman (hereinafter referred to as "Sherman"), and on December 27, 1956, Miles, Locke and Sherman entered into a written Amendment to the Agreement of October 8, 1956. [Tr. Vol. I, pp. 68-72, incl.] The Agreement is also in evidence as Exhibit AA [admitted Tr. Vol. II, p. 5], and the Amendment as Exhibit AC. [Admitted Tr. Vol. II, p. 8.]

The Agreement of October 8, 1956, in its Recitals, casts the background against which the parties contracted. Miles had been incorporated for the purpose of bidding upon, and performing if it were the successful bidder, one or more Military Housing Projects under



the Capehart Act (Title VIII of the National Housing Act) at Little Rock, Arkansas, and other locations; Locke had copies of the plans and specifications, and had performed some work in preparation for bidding.

The Agreement required that Locke go to Little Rock, and, at his own cost and expense, prepare a Bid for submission on the bidding date, October 11, 1956 (which was just three days after the Agreement was executed); in the preparation of the Bid, Locke was to act solely on his own behalf and at his sole cost and expense; he was to have no authority to contract on behalf of Miles, to incur expense on behalf of Miles, to represent Miles in any capacity whatsoever, or to submit a Bid on behalf of Miles; and he was to make available to Miles, and one of its officers, all plans and specifications, bidding information theretofore assembled, and all bidding information assembled during the course of the preparation of the Bid. Locke was to deliver to Miles \$25,000.00, to be used as a Bid deposit, not later than 10:00 o'clock a.m., on October 9, 1956. Miles was to submit a Bid on the bidding date. If Miles were the unsuccessful bidder, the other two Projects would be bid in a similar manner, with certain variations not important here. If Miles were the successful bidder at Little Rock, it was to have an option to confirm or reject the Bid; if rejected, Locke was to have certain rights in connection with it; and if Miles accepted the Bid, Locke was to receive \$15,000.00 in addition to reimbursement of the bid deposit. If Miles accepted the bid, Locke was to have no participation in the performance of the Contract, and was not to be entitled to exercise any control over perform-

ance. Nothing contained in the Agreement was to be construed as creating a Partnership or Joint Venture between Miles and Locke, or between the principals of Miles and Locke.

Thus, the Agreement itself shows clearly that the reason for the Locke Agreement was that Locke was, at the date of the Agreement, October 8, 1956, in possession of plans and specifications, together with some bidding information which, due to the obvious shortness of time, was needed by Miles, and was presumably essential to the preparation of an intelligent Bid on the Little Rock Project. However, the final determination as to whether or not a Bid would be submitted, and, if so, the amount of it, was left exclusively in Miles, and the Agreement required only that Locke make available such documents and information as he had in his possession when the Contract was executed, and that he travel to Little Rock and perform certain work during the three-day period between October 8, 1956, and October 11, 1956, in addition to advancing \$25,000.00, which was to be refunded to him. After the Bid went in, barring the application of the provisions of the Agreement concerning the bidding of other Projects, he was to have no further duties.

The Agreement provided further that Locke was to be additionally compensated, provided that Miles realized certain minimum percentages of "net return" from the Little Rock Project. Paragraph 11 provides:

" . . . Miles shall pay to Locke the sum of \$100,000.00 if, *but only if*, the 'net return', as said term is hereinafter defined, *to Miles*, result-

ing from the bidding, entering into, and performance by Miles . . . is at least three per cent (3%), but less than six per cent (6%), of the total amount of the Contract between Miles and the United States Government; or, if, *but only if*, the said 'net return' *to Miles* is six per cent (6%), or more, of the said Contract amount, Miles shall pay to Locke the sum of \$150,000.00. Provided, however, that there shall be deducted from any sum payable under this paragraph any amount which Miles shall have theretofore paid to Locke on account of bidding expense, or otherwise." (Italics added.)

We have emphasized in the above quotation the key words which, in our view, have a decisive bearing upon the issue before the Court.

Paragraph 12 (as amended by the Amendment to Agreement dated December 27, 1956), contains the definition of "net return". It reads:

" . . . the amount by which the total receipts of Miles under the said Contract exceed the aggregate of the cost of all labor, materials, and *services* expended or *incurred* in *bidding* the said Project, performing all acts necessary or appropriate to accomplish the construction, and closing . . ., actual construction, financing costs and expenses, and any and all other costs, expenses, charges, fees, taxes . . . deposits, bond premiums, and traveling and other expenses *of any nature whatsoever* expended or *incurred* in connection with such Project . . ." (Italics added.)

Here, also, we have emphasized the key words which, in our view, are determinative of the issue here involved.

In addition to the Assignment by Locke to Sherman of an interest in the Agreement, there were various Assignments made to other parties, that is, to Mr. and Mrs. Warren (Mrs. Warren having become, by marriage, Mrs. Dempster, by the time the action was filed, and having become, by marriage, Mrs. Norman by the time this action was tried), Truman Browne, Great American Indemnity Company (now Great American Insurance Company), Wren & Van Alen, Inc., Philip Yousem, Julian Weinstock Construction Co., and William J. Padden. Also, the United States of America claimed an interest in the funds. These Assignments and claims can, however, largely be discarded here, for the reason that no issue is raised on this appeal as to the priority established, or as to the determination of the validity of the Assignments, by the Judgment.

It appears from the recitals in the Amendment to Agreement dated December 27, 1956 [Tr. Vol. I, p. 68], that the Bid was prepared on the Little Rock Capehart Project, submitted, that Miles was declared to be the lowest acceptable bidder thereon, and a Letter of Acceptability was issued to it under date of December 5, 1956.

It also appears from said Amendment to Agreement that at or about December 27, 1956, Miles paid to Locke and Sherman the sum of \$40,000.00, consisting of the Bid deposit required by the Agreement of October 8, 1956, to be advanced by Locke, plus the additional \$15,000.00 required to be paid to Locke.



Thereafter Miles entered into the construction of the Little Rock Capehart Project, and completed it. Although for most purposes in this litigation, in the interests of convenience, it has been assumed by all parties that there was one Capehart Project at Little Rock, and that Miles performed it directly, there were, in fact, five Capehart Projects, all of which were initially awarded to Miles, which Miles performed as a participant in a separate Joint Venture as to each Project. In addition, there was an Offsite Contract (which was not a Capehart Project), which was performed through a Joint Venture participated in by Miles. [Ex. BI.]

However, Miles initially had, and continued to have, the primary liability under the Agreement of October 8, 1956, as amended, and, therefore, out of recognition of that liability, has participated, and is participating, in this litigation on its own behalf, and as a representative of the Joint Ventures as to which it was a participant. [Tr. Vol. II, pp. 73-74.]

The date on which this action initially was filed in the Superior Court does not appear in the Record. However, the Record does show [Tr. Vol. I, p. 42] that the Amended Complaint was filed in the Superior Court by the plaintiffs on May 10, 1960. It is established, therefore, that the action actually was commenced somewhat prior to that date. The Record also shows that, between the date of the filing of the Amended Complaint in the Superior Court and the date of the filing by the United States of America of its Petition for Removal to the Federal District Court, June 27, 1961, various Cross-Complaints and other pleadings were filed by various parties. [Tr. Vol. I, pp. 7, *et seq.*]



Miles (or, more accurately, the Joint Ventures which actually performed the construction) performed a large volume of the construction work through subcontractors. As is virtually inevitable in any construction activity involving, as here, in excess of \$22,000,000.00, there were various disputes and controversies which developed between the United States Government and Miles, and between Miles, its subcontractors and the sureties of the subcontractors.

By May 13, 1960, the actual construction work, to a very large extent, had been completed, and the United States Government had made payment to Miles of the consideration for the performance of the Capehart Act Contracts. However, as of that date, there existed a group of contingencies which made a determination of the amount of "net return" impossible for a protracted period of time.

As of May 13, 1960, there remained a group of controversies and litigation items pending and unsettled between Miles, as the General Contractor, and various of its Subcontractors and their sureties. These were the following:

(1) Mathis Company Heat Pump Controversy: The several Joint Ventures which performed the Capehart Contracts had entered into separate Subcontracts with the Mathis Company for the installation of heat pumps in the houses which were being constructed under the Project. The Contracting Officer of the Department of the Air Force demanded that the heat pumps which had been installed at that time be modified, contending that the heat pumps did not meet the plans and specifications. The Subcontracts to the Mathis Company

had required the installation of these heat pumps pursuant to plans and specifications, and the Mathis Company contended that they did so meet the plans and specifications. The cost estimates for making the modifications required by the Department of the Air Force ranged from \$400,000.00 to \$600,000.00. The Joint Ventures engaged in numerous conferences, and an appeal to the Secretary of the Air Force. Eventually a settlement was effected, under which the Mathis Company made certain modifications at a cost of approximately \$450,000.00. The modifications themselves were substantially completed by April 21, 1960. However, the Mathis Company, after completion of the modifications, asserted a claim against the Joint Ventures for substantial expenses incurred by the Mathis Company in making tests, and certain other expenses incurred in connection with the controversy. These claims were the subject of negotiations toward settlement, and settlement was eventually reached in September, 1960. [Ex. BF, Deposition of Edward Lester, pp. 4-8, incl.]

(2) J. E. H. Construction Associates—New Amsterdam Casualty Company controversy: Each of the Joint Ventures entered into a Subcontract with J. E. H. Construction Associates for concrete work on its segment of the Project. Each of these Subcontracts required the Subcontractor to file a Payment and Performance Bond, which Subcontractor did with New Amsterdam Casualty Company as Surety. J. E. H. Construction Associates encountered financial difficulties, and defaulted on April 17, 1958. The Joint Ventures were required to, and did, complete the work covered by the Subcontracts. The Joint Ventures asserted claims against New Amsterdam

Casualty Company under the Bond for the excess cost of completing the work over the Contract amounts payable to J. E. H. Construction Associates. Extensive negotiations failed to result in settlement, suit was filed against the Surety, further negotiations were had, and on July 29, 1960, a written Settlement Agreement was entered into, as a result of which the action was formally dismissed on August 16, 1960. Under the Settlement Agreement, New Amsterdam Casualty Company paid the Joint Ventures \$317,124.84, and assigned to the Joint Ventures a Maintenance and Warranty Escrow Fund in the amount of \$9,754.33. [Ex. BF, Deposition of Edward Lester, pp. 8-12, incl.; Ex. BF-1.]

(3) Union National Bank of Little Rock controversy: This controversy was indirectly related to the J. E. H. Construction Associates and New Amsterdam Casualty Company controversy. J. E. H. Construction Associates had been using Union National Bank of Little Rock for interim financing in the performance of its Contracts, and had executed an Assignment of all funds under the Subcontracts in favor of that Bank. At the time of the default by J. E. H. Construction Associates under its Subcontracts, it owed the Bank \$58,511.82. On December 4, 1958, the Bank sued the Joint Ventures, claiming that the Assignment of Contract funds constituted a prior Assignment against the Joint Ventures for this indebtedness. It was alleged that the Joint Ventures had paid \$58,511.82 to J. E. H. Construction Associates, and had failed to honor the Assignment of

funds to the Bank. After the addition of interest, the total demand in the suit against the Joint Ventures was \$71,876.18, and funds in this amount were impounded by the Bank from funds belonging to the Joint Ventures. After the settlement between the Joint Ventures and the New Amsterdam Casualty Company, the Union National Bank of Little Rock action was settled by the payment to the Bank by New Amsterdam Casualty Company of \$38,000.00, and Union National Bank of Little Rock paid to the Joint Ventures \$68,358.38, representing funds which had been impounded by that Bank. This resulted in the action filed by the Union National Bank of Little Rock's being dismissed on August 30, 1960. [Ex. BF, Deposition of Edward Lester, pp. 12-15 incl.; Ex. BF-2.]

(4) Texas Plumbing Co., Inc., controversies: Texas Plumbing Co., Inc., also was a Subcontractor of the Joint Ventures. It filed two actions against the Joint Ventures, both of which were still pending as of August 3, 1962, one in the Circuit Court of Pulaski County, Little Rock, Arkansas, and the other in the United States District Court for the Eastern District of Arkansas, Western Division, and both of which sought the recovery of \$39,869.29. In both of these suits, Texas Plumbing Co., Inc., which was the Subcontractor for the installation of plumbing work, claimed that the Joint Ventures destroyed part of the underground plumbing installed by that Subcontractor, and thereby caused damages in the amount of \$39,-



869.29. The suit in the State Court for the same amount asserted a claim for payment of alleged “extras” under the Subcontract, and that the Joint Ventures were negligent in damaging or destroying underground plumbing installed by the Subcontractor. The Federal District Court case, pending as of August 3, 1962, had originally been filed in the State Court on September 14, 1961, and was removed to the Federal Court on June 5, 1962. [Ex. BF, Deposition of Edward Lester, pp. 15-20; Ex. BF-3; and Ex. BF-4.]

(5) Gary H. Reid controversy: Gary H. Reid was the Subcontractor of the Joint Ventures for the brick work. On September 17, 1958, he refused to proceed with the performance of his Subcontracts, and filed suit against the Joint Ventures in the United States District Court, Eastern District of Arkansas, Western Division, for Declaratory Judgment. He subsequently amended his pleadings to seek recovery in the aggregate amount of \$29,775.00 for alleged conversion of personal property, loss of anticipated profits, and damages for delay, claiming also breach of Subcontracts by the Joint Ventures. After Reid’s refusal to proceed, the Joint Ventures completed the brick work themselves, and the cost was in excess of the Contract amount for three of the Joint Ventures. The Joint Ventures filed a Counterclaim seeking recovery of the aggregate of \$36,617.78. The case eventually was tried on November 29 and 30, 1960. After preparation of the Transcript and argument, the District Judge, on



June 21, 1961, rendered his decision, and entered Judgment against Reid and his Surety, Trinity Universal Insurance Company, for the amount of the Joint Ventures' Counterclaim. Gary H. Reid and his Surety appealed to the United States Court of Appeals, for the Eighth Circuit, and the case was taken under submission for decision on March 20, 1962. As of August 3, 1962, no decision had been rendered on the appeal. [Ex. BF, Deposition of Edward Lester, pp. 21-23, incl.] However, prior to the trial of this action, the Court of Appeals rendered its decision affirming the Judgment, and the case was awaiting a threatened Petition for Certiorari to the Supreme Court of the United States. [Ex. BG.]

All of these items of controversy involved litigation expense, consisting of costs of printing Briefs, traveling expense and attorneys' fees, a substantial portion of which remained to be incurred and billed in the future. [Ex. BF, Deposition of Edward Lester, pp. 24-25, incl.]

Contracts between the Government and Contractors on Capehart Projects (*i.e.*, Contracts under Title VIII of the National Housing Act, as amended) were subject, and therefore this Contract was subject, to renegotiation under the Renegotiation Act of 1951. (Title 50, U. S. C., §1216, subdv. (9).)

Miles, through the Joint Ventures which executed the performance of these Contracts, filed timely Renegotiation Reports, which were considered by the

Renegotiation Board, and attained finality on the following dates:

<u>Year</u>	<u>Filed</u>	<u>Date of Finality</u>
1957	1958 <sup>1</sup>	August 26, 1960 <sup>4</sup>
1958	1959 <sup>2</sup>	August 26, 1960 <sup>5</sup>
1959	1960 <sup>3</sup>	August 26, 1960 <sup>6</sup>
1960*	August 16, 1961 <sup>7</sup>	August 16, 1962
1961*	April 2, 1962 <sup>8</sup>	April 2, 1963

This case came on for trial before the United States District Court, Southern District of California, Central Division, Honorable Harry C. Westover, Judge, presiding, on October 30, 1962, and the trial was completed on October 31, 1962.

In due course, the Court caused to be entered Findings of Fact, Conclusions of Law, and Judgment [Tr. Vol. I, pp. 197-209, incl.], wherein it adjudicated that the various assignees of Locke and Sherman were entitled to recover from Miles the aggregate principal amount of \$135,000.00, together with interest thereon from June 13, 1960, to April 26, 1962.

Miles does not challenge on this appeal, in so far as it awards to the various assignees, the Judgment for principal in the amount of \$85,000.00, and Miles does not challenge the Judgment, in so far as it determines

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\*Statements of Non-Applicability.

<sup>1</sup>E<sub>xs.</sub> BA to BA-4, incl.

<sup>2</sup>E<sub>xs.</sub> BB to BB-4, incl.

<sup>3</sup>E<sub>xs.</sub> BC to BC-4, incl.

<sup>4</sup>E<sub>xs.</sub> BA-5 to BA-9, incl.

<sup>5</sup>E<sub>xs.</sub> BB-5 to BB-9, incl.

<sup>6</sup>E<sub>xs.</sub> BC-5 to BC-9, incl.

<sup>7</sup>E<sub>x.</sub> BD.

<sup>8</sup>E<sub>x.</sub> BE.

the priority between the various claimants. [Tr. Vol. I, p. 212 *et seq.*]

Miles does challenge the Judgment in so far as it awards the difference between \$85,000.00 and \$135,000.00 in principal amount to Appellee Great American Insurance Company, and Miles does challenge the Judgment in so far as it awards any interest (save and except only that earned on the \$85,000.00 of the Treasury Bills lodged with the registry of the Court during the time that they were so lodged). [Tr. Vol. I, p. 212 *et seq.*] These are the principal issues of this case.

The manner in which these issues were raised in the Court below is as follows: Miles stated, in its initial pleadings, that it was then uncertain as to the amount which would, eventually, be payable under the Agreement of October 8, 1956, as amended. [Tr. Vol. I, p. 52, *et seq.*] However, by the time required by the Court for filing Cross-Claim for Interpleader and Claim of Interest in Interpleader Fund against the funds then on deposit with the registry of the Court, sufficient information was available to Miles for it to determine that, as it considered the Agreement properly to be interpreted, there could not be more than \$85,000.00 payable under the Agreement, and that it, therefore, asserted this position in its Claim filed herein. [Tr. Vol. I, p. 116, *et seq.*, and p. 129, *et seq.*]

Appellee Great American Insurance Company, on the other hand, determined, by the time that it was required to file its Claim in Interpleaded Fund, that, under its interpretation of the Agreement, there was payable thereunder the sum of \$135,000.00 in principal,

and, also that the claimants to the fund were entitled to interest thereon for a period prior to the date of the initial deposit of the Treasury Bills in the registry of the Court, and so asserted these positions in its Claim. [Tr. Vol. I, p. 124, *et seq.*] Other appellees asserted similar positions as to interest in the claims filed by them.

The parties took the same positions, at Pre-Trial, and on the trial of the action.

On the trial of the action, Miles took the position, [Tr. Vol. II, p. 51, lines 1-2], and consistently maintained it, that the Agreement was free from ambiguity, and that no evidence in aid of interpretation was admissible. [Tr. Vol. II, p. 189, line 9.] The District Judge agreed and so held [Tr. Vol. II, p. 52, line 3; p. 189, lines 10-12], and Miles' position still is that this was a correct ruling.

There was no issue of fact left for determination by, or determined by, the District Court as to the amount of the Government Contract proceeds, and as to the amount of general costs and expenses of Miles. These were stipulated to and agreed to by the parties. [Tr. Vol. II, p. 145, lines 21-25; p. 146, line 20, to p. 156, line 4; p. 200, line 12, to p. 213, line 18.]

Moreover, there was not, in reality, a determination as a factual issue of the amount of "net return" realized as a result of the Capehart Contracts. While the Findings of Fact do contain a purported determination as



to this amount, with which we do not agree, it resulted solely from what we contend to have been an erroneous interpretation of the Contract by the District Judge. What we consider to be the correct interpretation of the Contract would have resulted in the "net return" amount which we contend to have prevailed.

As to the interest issue also, the District Court was not required to, and did not, determine the same through the resolution of a disputed factual issue, or disputed factual issues. The facts upon which this issue was determined were either stipulated to or were undisputed, and the District Court made its determination upon what we submit to have been an erroneous interpretation of the Agreement of October 8, 1956, as amended, and several erroneous conclusions which were drawn from the agreed to, or undisputed, facts.

### III.

#### **A Specification of Errors Relied Upon by Appellant Is as Follows.**

1. That the United States District Court erred in interpreting the Agreement of October 8, 1956, as amended by the Amendment of December 27, 1956, as allowing the assignees of A. T. Locke and John M. Sherman the gross principal sum of \$150,000.00, and the net principal sum of \$135,000.00, instead of the gross principal sum of \$100,000.00 and the net principal sum of \$85,000.00, against the undisputed evidence that Appellant Miles Construction Corp. did not realize a "net return" of 6% or more of "the total



amount of the Contract between Miles Construction Corp. and the United States Government”, as said terms are defined in said Agreement, as amended; and that Findings of Fact 19, 20, 22, 25, 26, 27, 28 and 29, the Conclusions of Law, and Judgment are, in that respect, unsupported by the evidence.

2. Said Court erred in interpreting the said Agreement of October 8, 1956, as amended, as calling for the payment of any sum thereunder from Miles Construction Corp. on the date which was thirty days after the receipt by Miles Construction Corp. of final payment under the Contract with the United States Government, despite the fact that the said Agreement of October 8, 1956, as amended, calls for such payment to be due on or before thirty days after the date on which Miles Construction Corp. received final payment under such Contract, or the date on which Miles Construction Corp. paid all costs and expenses incident to the performance of the said Contract, or the date on which Miles Construction Corp. has ascertained, by proper accounting procedures, the amount which would, by the said Agreement, be the “net return”, whichever was the later date; and that Findings of Fact 19, 20, 22, 25, 26, 27, 28 and 29, the Conclusions of Law, and Judgment are, in that respect, unsupported by the evidence.

3. The said Court erred in finding, contrary to the undisputed evidence, that on or prior to May 13, 1960, Miles Construction Corp. had paid all costs and ex-

penses incident to the performance of the said Contract with the United States Government; and that Findings of Fact 19, 20, 22, 25, 26, 27, 28 and 29, the Conclusions of Law, and Judgment are, in that respect, unsupported by the evidence.

4. The said Court erred in finding, contrary to the undisputed evidence, that Miles Construction Corp. was able, by proper accounting procedures, to determine, at or prior to May 13, 1960, the amount which would, by the said Agreement of October 8, 1956, as amended, be the "net return" thereunder, and Findings of Fact 19, 20, 22, 25, 26, 27, 28 and 29, the Conclusions of Law, and Judgment are, in that respect, unsupported by the evidence.

5. That the said Court erred in adjudicating that any amount became payable under the Agreement of October 8, 1956, as amended, prior to April 26, 1962, and that the said Court, therefore, erred in awarding interest against Appellant Miles Construction Corp. to Appellees Helen H. Dempster, William J. Padden, Truman Browne, and Great American Insurance Company from June 13, 1960, to April 26, 1962; and that Findings of Fact 25, 26, 27, 28, and 29, the Conclusions of Law, and Judgment are, in that respect, unsupported by the evidence.

6. That the said Court erred in adjudicating that the following Appellees were entitled to recovery from the interpleaded funds, or otherwise, of more than \$25,-

000.00, without interest, as to Appellee Helen H. Dempster, \$10,000.00, without interest, as to Appellee William J. Padden, \$7,500.00, without interest, as to Appellee H. Truman Browne, and \$42,500.00, without interest, as to Appellee Great American Insurance Company; and that Findings of Fact 19, 20, 22, 25, 26, 27, 28, 29 and 30, the Conclusions of Law, and Judgment are, in that respect, unsupported by the evidence.

7. That the said Court erred in finding that it was stipulated by all parties that A. T. Locke performed all acts required by him to be performed pursuant to the said Agreement of October 8, 1956, as amended December 27, 1956; and that Findings of Fact, the Conclusions of Law, and Judgment are, in that respect, unsupported by the evidence.

8. That the Court erred in finding that on December 28, 1956, A. T. Locke and John M. Sherman assigned to Wren & Van Alen, Inc., all moneys due, or which might thereafter become due, to A. T. Locke and John M. Sherman, from Miles Construction Corp., pursuant to the said written Agreements, and that the Findings of Fact No. 6, the Conclusions of Law, and Judgment are, in that respect, unsupported by the evidence.

9. That the Court erred in finding that Miles Construction Corp. stipulates and agrees that all interest on the Treasury Bills deposited with the Registry of the Court is the property of the assignees of A. T. Locke and John M. Sherman, and Findings of Fact 30, the Conclusions of Law, and Judgment are, in that respect, unsupported by the evidence.

IV.

**Argument.**

**1. Summary.**

In this case, the District Court had before it a Contract which required Miles to pay to Locke a sum of money in the future, which was contingent, as to whether any amount at all would be payable, upon whether or not Miles realized a "net return" on the Capehart Contracts with the Government, was further contingent as to the amount of money which would be payable dependent upon the amount of "net return" which was realized by Miles, and, lastly, was contingent as to the time that the same would be payable.

By Stipulation and undisputed evidence, the District Court had before it the text of the Agreement, the gross Contract receipts and the costs. It also had before it the contingent undetermined matters which left in a state of vast uncertainty, until down to the time of trial, the question as to how much the costs were, and, therefore, as to how much "net return" was, or would be, realized.

As we shall develop in the appropriate sections of this argument, Appellant Miles contends that the District Court erroneously interpreted the Agreement in such a manner as to award to the assignees of Locke the maximum amount of principal which could have been payable under the Agreement, as amended, although this result is prohibited by the express language of the Agreement itself, and, therefore, does violence to every rule of construction and interpretation. We also contend that, in determining that interest was payable to the assignees of Locke, the Court disregarded the



plain language of the Agreement, and undertook, in effect, to rewrite the Agreement, following the lead of the appellees, to make it read consistently with appellees' argument.

2. The Court Interpreted the Agreement Erroneously in Deciding That the Appellees Were Entitled to the Maximum Amount in Principal Thereunder.

Before turning to a discussion of this interpretation, it is in order to set down what we are talking about in dollars and cents. The total Contract Receipts on the Capehart Contracts between the United States Government and Miles are, consistently with the Stipulations and the Findings, \$22,611,439.58. [Ex. BI, top of p. 1; Tr. Vol. I, p. 203, lines 21-23.]

After the making of various adjustments (only one which is in dispute and is referred to in the next paragraph), the total costs, as adjusted, were \$21,-301,175.95, resulting, on these computations, in a "net return" of \$1,310,268.63, and a "net return percentage" of 5.579 of the Contract Receipts of \$22,611,439.58. [Ex. BI, p. 2.]

Essentially, none of these *figures* are in dispute. Concededly, however, the correctness of the inclusion in "cost of work in process", on the first page of this exhibit, of the sum of \$150,000.00, and the deduction of the sum of \$51,000.00, in the middle of page 2 of this exhibit, are challenged by Appellee Great American Insurance Company (hereinafter referred to as "Great American") and these items necessarily go to the heart of this issue. That which Great American contends (and that which, under Great American's inducement, the District Court was led to determine by its Judg-



ment) is that no part of any amount payable, or which might have been payable to, or for the account of, Locke under the Agreement should be considered as a part of "costs" in arriving at "net return"; that which Great American urged, and that which the District Court did, was to eliminate from costs any amount payable under the October 8, 1956, Agreement, as amended, from which the conclusion was then drawn that costs were only \$21,199,175.73 [Findings 19 and 21, Tr. Vol. I, pp. 204-205], resulting in a "net return" in excess of 6%, and in the gross amount of \$150,000.00 being payable under the Agreement, as amended.

Since Paragraph 11 of the Agreement requires Miles to pay a sum of money to Locke, dependent upon the amount of "net return", as otherwise defined in the Agreement, it is first in order to turn to Paragraph 12, which contains this definition. It is:

" . . . the amount by which the total receipts of Miles under the said Contract exceed the aggregate of the cost of all labor, materials, and services expended or incurred in bidding the said Project, performing all acts necessary or appropriate to accomplish the construction, and closing . . . , actual construction, financing costs and expenses, and any and all other costs, expenses, charges, fees, taxes . . . deposits, bond premiums, and traveling and other expenses of any nature whatsoever expended or incurred in connection with such Project. . . ."

This is, and obviously was intended to be, an all-inclusive definition of "costs". It specifically referred

to labor and materials, and to the cost also of *services* expended or incurred in *bidding* the Project, as well as all costs incident to actual construction, financing, etc.

The Record shows that Miles performed these Contracts under a percentage-of-completion method of accounting. [Tr. Vol. II, p. 94, line 20, to p. 95, line 16.] By this is meant, of course, that a Contractor establishes, at the outset of his work, an estimated cost as to each item which will be incurred from the beginning to the end of performance; for example, if a Subcontract which is let for all of the cement work totals, say, \$1,500,000.00, this will be set up, or "accrued", at least for percentage-of-completion accounting, along with all of the other items of cost, whether represented by Subcontracts or contemplated to be performed directly by the General Contractor, and, therefore, estimated by him.

Presumably, the Contractor would not have bid on the Contract in the first place unless he had estimated a profit representing the difference between the aggregate of the estimated cost of all of the items involved in carrying out the Contract, and the estimated Contract receipts. (Even the Contract receipts are necessarily estimated, because the Government has the privilege of making changes, deletions, or additions to the Contract, which will increase or decrease the Contract receipts, as compared with those reflected by the Contract in the first instance.)

Then, as the work progresses, and Contract proceeds are received, generally monthly, such Contract proceeds being disbursed to the Contractor on the basis of percentage of completion, are charged to each of the

items set forth in the estimate, including anticipated profit, according to the percentage that that item has been completed, and the difference, after such charges as to other items, is set up against the estimated profit.

Admittedly, the accounting method employed by Miles in the performance of the Capehart Contracts has little or nothing to do with the interpretation of the Agreement of October 8, 1956, as amended. However, an explanation of this accounting method is important with reference to the manner in which the potential liability under the October 8, 1956, Agreement, as amended, was handled.

The evidence shows that, initially, Miles contemplated the realization of in excess of 6% profit on the Capehart Contracts, and, therefore, consistently with the percentage-of-completion method of accounting, tentatively set up the aggregate of \$150,000.00 as a liability against this Contract. Prior to the commencement of construction, Miles disbursed to Locke and Sherman \$15,000.00, which was admittedly chargeable against this initial liability, which left the amount tentatively set up and undisbursed at \$135,000.00. As this Contract did not fall in the category of a labor and material Contract (*e.g.*, cabinets, the work on which was not even commenced until toward the end of construction), there was charged against it month to month a percentage representing the estimated percentage of completion which had occurred during the previous month.

It is, of course, true that, regardless of the accounting methods, the actual amount payable under the Agreement of October 8, 1956, as amended, could not

possibly be determined until all of the dust had settled, and the performance of the Contract had achieved finality. Therefore, if Miles had initially, for example, estimated a net return of, say, 4%, and if, when all the dust was settled, it turned out that the net return was 6½%, due to Miles' having overestimated costs, or for any other reason, it would follow that a larger amount than that initially set up in the estimate would be payable, and would not, in any way, be affected by the initial estimate.

It is clear that, regardless of what accounting method may have been employed, Miles commenced performance with a *potential liability* under the Agreement of October 8, 1956, as amended. Moreover, since Miles initially estimated a net return in excess of 6%, this potential liability initially assumed, and until all the dust had settled would continue to assume, the status of one reasonably to be anticipated to occur. At the very minimum, however, Miles must be held to have been required to assume that it would have to pay at least a gross of \$100,000.00 under the Agreement of October 8, 1956, as amended. Accordingly, it must be said that the moment the Capehart Contract was awarded to Miles, it "*incurred,*" within the exact meaning of Paragraph 12 of the Agreement, a liability to Locke or for his account, of at least a gross amount of \$100,000.00, against which it paid, at December 27, 1956, \$15,000.00.

While a catastrophe in the performance of the Capehart Contracts conceivably could have eliminated this as a liability, that is a speculation which is unproductive, for the reason that it did not occur. Thus, it



must be fairly said that, at the inception of the Project, Miles had a liability under the Agreement of \$100,000.00, representing the cost of *a service incurred in bidding the Project*, that this liability necessarily continued down to the date of the trial, and the various events which increased or reduced costs still in the process of occurring down to the date of the trial did not have, or could not have had, any effect on this minimum liability.

We think it probably unnecessary to turn to the books for a definition of the terms “expended” or “incurred.” Certainly this is so as to the word “expended.” This means “paid out in cash.”

At the risk of stating the obvious, we shall deal with the meaning of the word “incurred,” as to which we find some assistance in the California authorities.

In *Limited Mutual Compensation Insurance Co. v. E. G. Curtis*, 45 Cal. App. 2d 507, 114 P. 2d 404, where the question was one of venue, and specifically whether the obligation to pay premiums had been “incurred” in the City and County of San Francisco, California, the Court held that the provision in the policy requiring the payment of premiums in San Francisco constituted the “incurring” of the obligation under §395 of the California Code of Civil Procedure, with the result that venue properly lay in the City and County of San Francisco.

In *Capuccio v. Caire*, 215 Cal. 200, 277 Pac. 475, 73 A. L. R. 8, where the question was whether attorneys’ fees in a partition action under Code of Civil Procedure



§796 had actually to have been paid before they could be allowed, the Court held that a reasonable construction of the Code Section was that the word “expended” should be deemed equivalent to the word “incurred,” and that the fees had been “expended” when the obligation to pay them arose.

In *Weinberg v. Heller*, 73 Cal. App. 769, at 780, 239 Pac. 358, the Court held that it was not necessary to show proof of actual payment of attorneys’ fees and costs under an agreement reading: “. . . the undersigned shall not be required to advance or pay any cost or expense incurred by said attorneys, except that the Weinberg Company . . . shall advance and pay eight-fifteenths (8/15ths), and that Rosa Heller shall advance and pay seven-fifteenths (7/15ths) of all the costs of court incurred in this action . . .” The Court said:

“. . . when the expense was incurred, Weinberg became liable therefor, and by the terms of the contract seven-fifteenths thereof then became due from the appellant. The legal definition of the term to ‘incur’ has been announced in many decisions in various jurisdictions. The supreme court of Oklahoma, in *Bank v. Eckles*, 19 Okl. 159 [91 Pac. 695], said:

“The word “incurred” is defined by Webster as “to become liable for or subject to”; “to render liable or subject to.” Black says: “Men contract debts. They incur liabilities. In the one case, they act affirmatively; in the other, the liability is incurred or cast upon them by

operation of law. 'Incur' means something beyond contracts, something not embraced in the word 'debt.' ”

The Court also quotes from *In re McElheny*, 91 App. Div. 131 [86 N. Y. Supp. 326], where it is stated:

“‘Suffered’ means ‘paid,’ ‘incurred’ means ‘become liable for.’ The language is, ‘we hold ourselves responsible for costs and damages which may be incurred by said Van Dolsen,’ not ‘which he may suffer’; and the purport of the language is the same as though it read ‘which he may become liable for,’ because *the incurring of a liability does not necessarily mean that such liability has been paid.*” (Emphasis ours.)

In *County of Kings v. Scott*, 190 Cal. App. 2d 218, 11 Cal. Rptr. 893, where the question was whether or not a County had a fixed and imposed charge against a defendant for hospitalization, the Court held that where the joint pre-trial statement stipulated that the County had “incurred” bills for hospitalization, and that the amount stated was “now due”, could only mean that the County of Kings had a fixed and imposed charge against the defendant, the Court saying:

“The word ‘incurred’, when used in connection with bills or expenses, means to become liable for and to have liability thrust upon one by act or operation of law.”

It must be fairly said, from both common knowledge and from the above authorities, that a cost which is “incurred” includes a cost which is “expended” or paid,

and it also includes a cost which is an obligation even though not paid, and that a cost is no less "incurred" when the amount of it is uncertain at the time of its origin than it would be if the amount were certain at the time of its origin. Dictionary definitions tell us that we "incur" an obligation when we commit an act of negligence injuring the property or person of another, although it remains for future adjudication or determination as to the amount of that obligation. The incurring occurs as a result of the act, and the obligation itself may be forced upon us by operation of law.

It follows beyond question, then, that Miles "incurred" an obligation to Locke when it executed the Agreement of October 8, 1956. At the point of execution, its sole obligation was to cooperate with Locke, and, in good faith, put together a Bid on the Little Rock Project, reserving to itself the decision as to whether it would submit that, or some other, Bid.

However, if Miles were the successful bidder, and if it elected to take the Contract, then it incurred, at the point of that election, two obligations: (1) To pay Locke \$15,000.00; and (2) To pay Locke an additional sum of money, if certain events transpired in the future.

We are not, of course, concerned here with the \$15,000.00, since this admittedly was paid along with the reimbursement of the Bid deposit.

However, it is clear that, when Miles elected to take the Contract, it "incurred" an obligation to pay an additional sum of money under given circumstances.

Without reference to the time when payment should be made (which is specifically spelled out in the Agreement and dealt with elsewhere), if it could be tenably argued an obligation in excess of \$15,000.00 was not initially incurred in favor of Locke, an obligation inevitably became "incurred" when events occurred which made "net return" more than 3%, regardless of whether anyone had computed or investigated this question. Moreover, at least \$100,000.00 was so "incurred" when events had transpired which showed "net return" to be more than 3%, regardless of whether or not the \$100,000.00 was considered a part of cost.

How can it be said, then, that when it was ascertained that Contract receipts and costs were such as to yield a "net return" of more than 3%, regardless of whether or not any sum of money under the Agreement was considered as a part of costs, that the amount so "incurred" is not a part of net costs under the definition contained in the Agreement?

We return now to Paragraph 11, which says that "Miles shall pay to Locke the sum of \$100,000.00 if, *but only if*, the 'net return' . . . to Miles, resulting from the bidding, entering into, and performance by Miles . . . is at least three per cent (3%) . . ."

Concededly this provision came into play, and no question exists as to the gross amount of \$100,000.00 being payable.

Paragraph 11 then goes on to say that "if, *but only if*, the said 'net return' to Miles is six per cent (6%), or more, of the said Contract amount, Miles shall pay to Locke the sum of \$150,000.00." (or an additional \$50,000.00).



It must here be pointed out that Appellant Miles is *not* contending that this additional \$50,000.00 is to be deemed a part of costs in determining the amount payable to Locke under the Agreement. Such a contention is unnecessary, and would, therefore, be misplaced. The inclusion or exclusion of this additional \$50,000.00 as a part of cost does not change the result.

The fact remains that the precise language of the Contract states that the only circumstance under which there is payable the additional \$50,000.00 is that the “net return” to Miles must be 6%, or more, of the Contract amount.

The District Court eliminated the initial \$100,000.00, which as we have seen was incurred as one of the costs the moment the Capehart Contract was awarded to Miles, despite the fact that it was incurred as a part of bidding expense, and, as a result, concluded that the “net return” to Miles was \$100,000.00 more than it actually was, and that Miles, therefore, realized a “net return” of more than 6%.

This does extreme violence to the express language of the Agreement. By so concluding, the District Court has cut the “net return” to Miles to 5.57%. The addition of \$50,000.00 to Miles’ costs, as claimed by them in Exhibit BI, brings the costs actually to \$21,351,175.95, reduces net return to \$1,260,263.63, and results in an effective percentage of net return *to Miles* of 5.57. This result is reached in the face of clear and unequivocal language in the Agreement that “if, *but only if*, the ‘net return’ to Miles is 6%, or more,” shall the additional \$50,000.00 be paid.



### 3. The District Court Erred in Failing to Follow Accepted Rules of Contract Interpretation.

It is clear that this Agreement, executed in California, to be performed (as to payment) in California, and being litigated between California residents, is to be interpreted under California law.

*California Civil Code* §1641 requires that

“The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other.”

We submit that, in interpreting the Agreement as was done in the Judgment, the District Court ignored this injunction, when it refused to give effect to the “*if, but only if*” clause.

This Agreement is neither an “Employment Agreement”, nor is it a “Profit-Sharing Agreement”, but, if cases dealing with either of these have a bearing, they are, in so far as we can discover, unanimous in holding that express contract language controls, and must be given full effect. *Bishop v. Kelly*, 100 Cal. App. 2d 775, 224 P. 2d 814 (1950).

*Bishop v. Kelly* also suggests the proper approach to the construction of the Agreement in the case at bar. There, an employee was entitled to a salary and a share in profits. The Trial Court ordered that the referee determine net profit, after deducting “liabilities incurred for operating expenses *including the salary paid to defendant.*” (Italics added.) (100 Cal. App. 2d at p. 781.) In the case at bar, the Agreement requires *setting aside 3%* of “net return” to Miles, *before* Locke is entitled to anything other than \$15,000.00 al-

ready paid, and when, by this process, Locke becomes entitled to \$100,000.00, it must, like the defendant's salary in *Bishop*, be considered "incurred", and added to costs in determining "net return" as to the remaining \$50,000.00. This is the exact result achieved in Exhibit BI.

Our research has led us to no case holding or suggesting that, where a contract calls for setting aside to one party a specified amount or percentage before a specified amount or percentage is to be paid to the other, the initial amount or percentage to be set aside is to be disregarded. On the contrary, what light the cases do shed is squarely in the opposite direction.

For example, *Winkelman v. General Motors* (D. C. S. D. N. Y.), 44 F. Supp. 960, discloses that 7% of "capital employed" was first to be set aside from net income, before remaining profits were to be divided, *across the board*, between executives and shareholders. No one even had the temerity to suggest that this did not mean exactly what it said. Obviously, if 7% of "capital employed" had been equal to, or less than, net profit, there would have been nothing to share *across the board*.

In the case at bar, the Agreement required that these steps and procedures be engaged in in determination of the amount payable under it:

1. To ascertain, under the definition in the Agreement without regard to any amount payable to Locke, the "net return" that Miles realized.

2. If this is more than 3% of Contract Receipts, then it is established that Locke is entitled to additional compensation.

3. If the “net return” originally arrived at shows that Miles realized a net return in excess of 3% of Contract Receipts and if after setting 3% of Contract Receipts aside to Miles, there remains \$100,000.00 in net return, then Locke becomes clearly entitled to \$100,000.00.

4. At this point in the computation the cost figure must necessarily be revised because it has now been ascertained that Locke is clearly entitled to at least \$100,000.00. Therefore the cost figure initially used must be increased by \$100,000.00, and the computation must be made to ascertain whether or not this allows a net return which is more than 6%.

5. “If and only if” (to use the express contract language) this yields a percentage of more than 6, is Locke entitled to anything in addition to the \$100,000.00 less the \$15,000.00 already paid. The amount in excess of such \$100,000.00 would depend upon the extent to which there was sufficient money to pay Miles its 6% of Contract Receipts.

Here the application of these rules, which are mandatory under the Agreement, yields the precise result for which we contend. The application of these rules shows that once it is apparent that Miles has realized more than its full 3%, and once it is apparent that the payment of \$100,000.00 will not result in an erosion of Miles’ 3%, then the \$100,000.00 becomes allocated to cost, resulting in reduction of net return by \$100,000.00, and the net return so arrived at, when compared with gross receipts, is 5.795%. This is less than 6%, and it follows that since Miles has not achieved 6% or more, Locke is entitled to nothing more than the \$100,000.00.

4. Even if the Principles of Interpretation Adopted by the District Court Are Conceded, No More Than \$85,000.00 Became Due Under the Agreement.

In Finding 24 [Tr. Vol. I, p. 204], the Court found:

“24. On May 13, 1960, Miles Construction Corp. received payment for the construction of the said Capehart Housing Project, and prior thereto and as an inducement therefor, represented to the Government of the United States that all construction costs had been paid or provided for.”

In Finding 25, immediately following, the Court found:

“25. It is not true that Miles Construction Corp. paid any costs of construction, as defined in said Agreements referred to in Paragraphs 2 and 4 of these Findings, after May 13, 1960.”

These Findings, together with the Judgment based upon them, demonstrate clearly that the District Court concluded that a proper interpretation of the Agreement was that *any* event which occurred subsequent to May 13, 1960, could not be considered in determining the amount of “net return”, and the percentage which this bore to Contract receipts.

Assuming, for the purpose of argument, that this conclusion is valid, the further conclusion inevitably follows that the maximum amount which could be payable under the Agreement is \$85,000.00, even if no part of the amount payable under the Agreement is regarded as costs in determining “net return”, as the following reconstruction will show.



For purposes of reconstructing the situation as of May 13, 1960, we refer to Exhibit BI, which shows "Cost of Work in Process" at \$21,659,500.12. Other adjustments of relatively small amounts should be considered for an entirely accurate reconstruction, but they obviously would not change the result of this reconstruction.

However, for the purpose of this reconstruction, we deduct from this figure of work in process the sum of \$150,000.00 (being the gross amount initially accrued on the books with reference to the Locke Agreement), and admittedly included therein. This deduction reduces the Cost of Work in Process figure to \$21,509,500.12. This results in the net return being approximately \$1,100,000.00, and the percentage of net return to Contract Receipts being approximately 4.86%. (It is obvious, without going further, that if the figure of \$28,931.28, at the bottom of page 1 of Exhibit BI, were added to costs, and the figure of \$19,462.94, shown at the top of page 2 of Exhibit BI, were deducted from costs, they would effect no change of significance.)

This 4.86%, as we have noted, is arrived at by the backing out of the Work in Process figure the entire amount payable under the Locke Agreement. Even after doing so, the percentage figure dictates that the gross amount of \$100,000.00, and a net amount of \$85,000.00, in principal, would have been due, and no more, under the Agreement.

In concluding otherwise, the District Court had to reach *beyond May 13, 1960*, and pull in the recovery which the Joint Ventures later gained upon the settle-



ment of the litigation involving J. E. H. Construction Associates, and New Amsterdam Casualty Company. This amount was \$316,792.51. [Ex. BI, p. 1; Ex. BF, pp. 10-11.]

This recovery was not, in any sense of the word, a Contract receipt, because it was not a part of the moneys paid by the United States Government to Miles. Indeed, no contention has been made that it should be treated as a part of Contract receipts. If it has any effect, it is only to reduce costs, but its recovery did not occur until substantially after May 13, 1960, the date on which the District Court held that rights under the Locke Agreement became “fixed”.

It follows that, if the District Court did not commit error in finding [Finding 25] that Miles was paid no construction costs after May 13, 1960 (and we contend elsewhere in this Brief that this Finding was in error), then, according to all concepts of logic, the recovery by Miles on the settlement of the litigation must be disregarded.

Perhaps, however, the District Court intended to hold, and held in effect, one or the other of the two following things:

(1) That at May 13, 1960, there became due under the Locke Agreement the amount of money which net return and percentage of net return to gross receipts then dictated. As we have seen above, this percentage was approximately 4.86% (even without considering as a part of costs any amount payable under the Agreement). Thus, the conclusion is inescapable, under this approach, that a gross amount of \$100,000.00 in prin-

cial became irrevocably "incurred", and, therefore, properly to be "accrued", as of that date. When so incurred and so accrued, it necessarily became irrevocably, as of that date, a part of costs. Perhaps, also, following this line of reasoning, the District Court held, or intended to hold, that the determination as to whether there would be an additional \$50,000.00 payable under the Agreement would have to abide a final determination of the contingencies which would either thereafter reduce or increase costs. If so, this line of approach does not support the Judgment.

For a determination as of May 13, 1960, that, as of that date, there was payable under the Locke Agreement a gross amount of \$100,000.00 forces the addition of this gross amount to costs, and the subsequent accrual of the J. E. H. —New Amsterdam recovery, does not change the result; *the result is precisely as set forth in Exhibit BI.*

(2) Perhaps, again, the District Court intended to hold, and did hold, that, as of May 13, 1960, there should have been accrued contingent and estimated claims against Miles which might, and, to the extent of litigation expense inevitably would, add to costs and reduce net return, and that there should also be deemed to be accrued as of May 13, 1960, possible recoveries by Miles, which would subsequently reduce costs, and thereby increase net return.

While hindsight, and only hindsight, tells us, and even this only partially, what would have been the appropriate amounts to consider subject to accrual as of May 13, 1960, and, therefore, this involves a vast area

of speculation, it is illuminating, or at least interesting, to engage in such a speculation.

The fact that litigation was then pending with the New Amsterdam Casualty Company would scarcely justify an "accrual" of that which was eventually recovered. However, assume for the purpose of argument that \$200,000.00 is "accrued" as something which might reasonably be expected to reduce costs in the future as to this contingency. Deducting this from the Work in Process figure of \$21,659,500.12 leaves \$21,459,500.12. Without going farther, and after making the admittedly appropriate other adjustments, this would have left total costs, as so adjusted, at \$21,417,968.46 (arrived at by adding the excess of the actual subsequent J. E. H.—New Amsterdam recovery above \$200,000.00, or \$116,792.51, to total cost, as adjusted, shown on page 2 of Exhibit BI.)

This figure, however, still includes \$100,000.00 of the \$150,000.00 initially accrued under the Locke Agreement, so, for the purpose of argument here, we deduct \$100,000.00, leaving \$21,317,968.46.

This, without considering any contingencies, leaves a net return which is less than 6% of Contract receipts.

However, obviously and logically, other accruals would have to be made.

The Bank in Little Rock apparently had run a non-judicial "attachment" against Miles by impounding in excess of \$71,000.00 of its funds. [Ex. BF, p. 14.] These were, as of May 13, 1960, unavailable to Miles, although they are not expensed as a cost in the Work in Process figure. At May 13, 1960, however, Miles

was threatened with the loss of them. For purposes of argument and engaging in this speculation, we assume that \$40,000.00 should be accrued here.

Gary H. Reid had asserted claims aggregating approximately \$30,000.00 in principal, and Miles had Counterclaims aggregating \$36,000.00 in principal. For purposes of this speculative argument, these, for accrual purposes, may be deemed to offset one another (although, clearly, Miles could have ended up losing its Counterclaim, and having a Judgment against it).

The Texas Plumbing Co., Inc., cases involved a claim against Miles of approximately \$40,000.00. This has never been determined, and Miles may yet have to stand this claim, plus its litigation expense and costs, when it is finally adjudicated. For purposes of this argument, we “accrue” this as of May 13, 1960.

Obviously, either an accrual on account of the bank claim or the Texas Plumbing claim would increase costs by \$40,000.00, to \$21,357,968.46, which would further drop net return below 6%, even if no part of the amount payable under the Locke Agreement were considered as cost.

Thus, if this assumption were the holding of the District Court, the maximum which could be adjudicated to be payable under the Locke Agreement in principal would be \$85,000.00.

##### **5. The Court Erred in Allowing Interest.**

The District Court, in its Judgment, allowed the appellees interest from June 13, 1960, to April 26, 1962 [Tr. Vol. I, p. 11, line 31, to p. 12, line 20.] Miles' contention is that the facts do not sustain this allowance.



The Agreement is, of course, silent as to interest. The rule is that, when a contract for the payment of money is silent as to interest, the law awards interest at the legal rate from the time it becomes due and payable, if such time is certain or can be made certain by calculation. *Flynn v. California Casket Co.*, 105 Cal. App. 2d 196, 233 P. 2d 131 (1951), and cases therein cited. But if a claim is uncertain or unliquidated, interest is not recoverable until it is made certain and becomes liquidated, by Judgment or otherwise. *Perry v. Magneson*, 207 Cal. 617, 279 Pac. 650 (1929).

The basic question, here, is, when did this claim become “due and payable”? The Agreement tells us. Paragraph 11 says:

“ . . . Said payment shall be due on or before thirty (30) days after the date on which Miles receives final payment under the Contract, or any additions or supplements thereto, or *the date on which Miles has paid all costs and expenses incident to the performance of the Contract*, or the date on which Miles has ascertained, by proper accounting procedures, the amount which would, by this Agreement, be the ‘net return’, whichever is the later date.” (Italics added.) [Tr. Vol. I, p. 64.]

The District Court, by its Judgment, ignored *all* of the above-quoted provision, except the part having reference to the date of receipt of final payment. This, alone requires a reversal of the Judgment.

How can it possibly be said that Miles was able to determine the amount which would be “net return” on May 13, 1960 (thirty days before the date on which



the Judgment commences accrual of interest) when, at that date, four major items of controversy and litigation were pending and undetermined; and when Renegotiation was still in progress, together with the attendant costs and expenses, any one of which, or which in the aggregate, would have had, and several of which did in fact have, a substantial effect on the amount of "net return"?

(a) *Contingent Claims and Litigation.*

The answer is obvious. The then pending litigation with J. E. H. Associates and the New Amsterdam Casualty Co., alone, involved several hundreds of thousands of dollars. Recovery on it, and the extent of recovery were not, and could not have been, known. Unless it can be said that this then contingent claim in favor of Miles, as well as all other contingent claims against Miles, are properly to be disregarded for *all purposes*, it cannot be said that "net return" was susceptible to computation on May 13, 1960.

Nor may this date properly be advanced to July 29, 1960, the date of the Settlement Agreement with the New Amsterdam Casualty Co. There remained, long after this date, substantial contingencies which rendered impossible the determination of the amount of "net return."

Actually, as a matter of law, it was not possible to determine the amount of net return until, *at the earliest*, the Gary Reid litigation and controversy achieved finality, a date *later* than April 26, 1962. As a matter of law, so long as Miles was exposed to the danger of a reversal of the Judgment in this case, with the attendant

burden of having the Gary Reid claim, plus its own litigation expense, including attorneys' fees, it was impossible to determine the amount of "net return."

Moreover, simple arithmetic tells us that if the principal amount of the Gary Reid claim against Miles (\$29,775.00), and the principal amount of the Texas Plumbing Co., Inc., claim against Miles (still pending, \$39,869.29) are added to Total Cost (as adjusted) on page 2 of Exhibit BI ( $\$21,301,175.95 + \$69,644.20 = \$21,370,820.24$ ) and *\$100,000.00 is deducted*, cost would become \$21,270,820.24, "net return" would become \$1,340,619.34, and percentage of net return would be less than 6%.

In Finding 25, the District Court finds that Miles did not pay any "costs of construction" after May 13, 1960. Exactly what is meant by this escapes us, but if it means payment for labor and materials actually incorporated in the work at the site, it is contrary to the undisputed evidence, and, in addition, we submit is irrelevant. Certainly, it cannot be said *any* claim relating to actual construction is not a construction cost; yet the evidence shows that final settlement of the Mathis Co. Heat Pump matter was resolved and paid substantially after May 13, 1960 [Ex. BF, pp. 4-8 incl.], and this was, beyond a doubt, an actual construction cost matter.

So, also, in fact, as to all other matters of Little Rock litigation. Each of them arose directly from actual construction activity. J. E. H. Associates-New Amsterdam and Union National Bank from concrete work; Gary Reid, brick work; Texas Plumbing, plumbing work.

But even if it were not so, this challenged Finding is irrelevant because the Agreement deals not just with actual construction costs but costs “. . . of any nature whatsoever expended or incurred in connection with such Project. . . .” (Italics added.) [Tr. Vol. I, p. 70.]

Therefore, so long as costs and expenses were being incurred, and so long as substantial contingent claims and items remained unresolved, it was not and could not be a fact that Miles had paid “all costs and expenses incident to the performance of said Contract,” or that Miles, or anyone else, could ascertain the amount which would be “net return.”

It follows that no amount became due and payable under the Agreement prior to April 26, 1962, and that the allowance of interest was error.

(b) *Renegotiation.*

The significance of the evidence on this subject is that, until finality of all Renegotiation proceedings, it was not known, and could not be known, whether Miles was to be permitted to retain all of its Contract Receipts; if it had been required to repay a part of them to the United States Government, this obviously would have reduced “net return”.

Renegotiation is provided for in Title 50, Section 1211, *et seq.*, U. S. C.

Section 1216 lists certain mandatory exemptions, the last of which is:

“Any contract, awarded as a result of competitive bidding, for the construction of any building, structure, improvement, or facility, *other than a*

*contract for the construction of housing financed with a mortgage or mortgages insured under the provisions of title VIII of the National Housing Act, as now or hereafter amended.”* (Emphasis added.)

Title VIII of the National Housing Act is a section of the law popularly known as the “Capehart Act”.

It is this provision in the law which rendered the Government Contracts performed at Little Rock, Arkansas, subject to Renegotiation.

Section 1213(i) provides that the terms “‘received or accrued’ and ‘paid or incurred’ shall be construed according to the method of accounting employed by the contractor . . . .”

Under §1215(e)(1), the Renegotiation Board is authorized to prescribe by Regulation the form and the manner of submitting Reports. This the Board has done, and the Regulations require that each entity shall file a full Report for any year in which it has Renegotiable business of \$1,000,000.00 or more, and that, if any such entity has less than \$1,000,000.00 of Renegotiable business, it shall file a Statement of Non-Applicability showing the amount of its Renegotiable business.

In §1215(c), it is provided that no proceedings for Renegotiation shall be commenced more than one year after the Statements are filed, and that, if no agreement or Order determining excessive profits is made within two years following the commencement of Renegotiation proceedings, then, upon the expiration of the two years, all liabilities of the contractor for excessive profits shall terminate.



Here, as shown by Exhibits BA to BC-9, inclusive, BD and BE, full Renegotiation Reports were filed for the years 1957, 1958, and 1959, respectively, and were considered by the Renegotiation Board which determined that, for those years, no Renegotiation repayments were required.

For the year 1960, Statements of Non-Applicability were filed, as Receipts were less than \$1,000,000.00. However, this was the year of the J. E. H. Associates—New Amsterdam recovery, and also the year of the final payment under the Contract. These statements were filed August 16, 1961, and the Renegotiation Board, under 50 U. S. C. 1215(c) had one year (until August 16, 1962) within which to commence Renegotiation proceedings thereon.

For this reason alone (as well as in combination with other contingencies), it was not possible to determine, finally, “net return” until August 16, 1962, and it was error for the Court to allow interest for any period prior to August 26, 1962.

#### **6. Miscellaneous Assignments of Error.**

In the forgoing argument, we have discussed our position with reference to Assignments of Error Nos. 1 to 6, inclusive. The others we deal with briefly here.

Assignment No. 7: Although the Record does not support a Finding that Miles stipulated that Locke had performed all acts required of him by the October 8, 1956, Agreement, as amended, no issue was raised as to this at the trial, and this Finding, by itself, does not call for reversal. However, out of perhaps an excess of caution, we assign this as error, since, in the event that there is a reversal on other grounds, we cannot be sure



of the course which this litigation might subsequently take, and we do not wish to be bound by a Finding which is contrary to the evidence, in the event the question subsequently may become of importance.

Assignment No. 8: We assign as error the Finding that on December 28, 1956, Locke and Sherman assigned to Wren & Van Alen, Inc., all moneys due or that might become due to Locke and Sherman from Miles under the Agreement. This, again, alone does not require reversal, but it is contrary both to the evidence and to the other Findings, as the evidence showed, and the Court found, that previous Assignments had been made by Locke and Sherman. We, therefore, assign this as error, so that, in the event of a reversal, we would not be bound by a conflicting Finding.

Assignment No. 9: The Record does not support a Finding that Miles Construction Corp. stipulates and agrees that all interest on Treasury Bills deposited with the Registry of the Court is the property of the assignees of A. T. Locke and John M. Sherman. That which Miles did stipulate to was that the interest which such Treasury Bills earned, or might earn, while on deposit with the Registry of the Court, would follow and become the property of the assignees who were finally adjudicated to have an interest in the funds, in proportion to their interest. [Tr. Vol. II, p. 196, lines 2 to 23, incl.] This, alone, also does not require reversal. However, if the action is reversed on other grounds, it should be reversed with respect to Finding of Fact No. 30, as, in that circumstance, an ultimate decision would not necessarily award interest earned on more than the aggregate of \$85,000.00 to the appellees.

V.

**Conclusion.**

By way of summary of its argument, appellant contends that the plain language in the Agreement between the parties requires that, once it becomes clear that the gross amount of \$100,000.00 is payable under the Agreement, this amount must be deemed "incurred" as bidding expense, must be added to costs, that the costs, after such addition, must be deducted from Contract Receipts to arrive at "net return", and, when "net return" so arrived at is compared with Contract Receipts, the percentage is 5.795; and that it follows, therefore, that the appellees are entitled to \$85,000.00, only, in principal amount.

Appellant further contends that even if the \$100,000.00 is not to be deemed "incurred" in this fashion, it properly is to be deemed "incurred" as of May 13, 1960, the date on which the Court held that the amount payable under the Agreement became due and payable, for the reason that, as of that date, and under that ruling, by any process of reconstruction, the percentage which "net return" bore to Contract Receipts was substantially less than 6% *without* the accrual of *any* amount under the Agreement itself; and that, upon such accrual, none of the events which transpired subsequently could, or would, affect the result.

Appellant contends, upon the subject of interest, that, in no event, does the evidence justify a holding that any amount became due and payable under the Agreement prior to April 26, 1962, and that, therefore, the award of any interest prior to that date to the appellees is not supported by the evidence.

Appellant further contends, on the subject of interest, however, that, if the District Court is correct in holding that any amount became due payable under the Agreement as of thirty days after May 13, 1960, then it follows that the sum that so became due and payable was \$85,000.00 and no more, and that, therefore, interest could not properly be allowable on more than this amount.

Appellant also contends that there is an irreconcilable inconsistency in the Findings of Fact, Conclusions of Law, and Judgment, when considered in the light of the undisputed evidence, in that, by them, the District Court holds that the maximum amount in principal which could be payable under the Agreement became due and payable as of thirty days after May 13, 1960, yet, the only way in which this result could be reached was to take into consideration a series of contingent items which occurred after, and some of them substantially after, the date of May 13, 1960.

For these reasons appellant feels that the Judgment should be reversed.

Respectfully submitted,

FORSTER, GEMMILL & FARMER,  
By JOHN G. GEMMILL,  
*Attorneys for Appellant.*

**Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN G. GEMMILL









## APPENDIX.

### Table of Exhibits.

(References are to Transcript, Volume II)

<u>Exhibit No.</u>	<u>Identified</u>	<u>Offered</u>	<u>Received</u>	<u>Rejected</u>
1	p.17,1.18	p. 17,1.18	p.18,1. 6	
2	p. 6,1.12	p. 6,1.15	p. 6,1.19	
CA	p. 6,1.24	p. 7,1.11	p. 7,1.13	
AA	p. 5,1. 1	p. 5,1. 5	p. 5,1.16	
AB	p. 6,1. 1	p. 6,1. 3	p. 6,1. 6	
AC	p. 7,1.24	p. 8,1. 2	p. 8,1. 5	
AD	p. 9,1.25	p. 10,1. 7	p.10,1.11	
AF	p.22,1.20	p. 23,1. 1	p.24,1. 4	
AG	p.25,1. 6	p. 27,1.17	p.29,1.20	
AH	p.38,1. 2	p. 43,1.15	p.43,1.19	
AI	p.39,1.22			
DA	p.13,1.24	p. 14,1.24	p.16,1.21	
DB	p.84,1.10	p.110,1. 2		p.110,1. 6
BA	p.56,1.16	p. 56,1.16	p.57,1. 4	
BA-1	p.57,1.10	p. 57,1.10	p.57,1.14	
BA-2	p.57,1.18	p. 57,1.18	p.57,1.24	
BA-3	6.58,1. 1	p. 58,1. 1	p.58,1. 5	
BA-4	p.58,1. 9	p. 58,1. 9	p.58,1.13	
BA-5	p.69,1.20	p. 69,1.20	p.69,1.22	
BA-6	p.69,1.25	p. 69,1.25	p.70,1. 2	
BA-7	p.70,1. 6	p. 70,1. 6	p.70,1. 8	
BA-8	p.70,1.11	p. 70,1.11	p.70,1.13	
BA-9	p.70,1.17	p. 70,1.17	p.70,1.20	
BB	p.58,1.17	p. 58,1.17	p.58,1.21	
BB-1	p.58,1.25	p. 58,1.25	p.59,1. 4	
BB-2	p.59,1. 8	p. 59,1. 8	p.59,1.12	
BB-3	p.59,1.16	p. 59,1.16	p.59,1.20	
BB-4	p.59,1.24	p. 59,1.24	p.60,1. 3	
BB-5	p.70,1.24	p. 70,1.24	p.71,1. 1	

<u>Exhibit No.</u>	<u>Identified</u>	<u>Offered</u>	<u>Received</u>	<u>Rejected</u>
BB-6	p.71,1. 5	p. 71,1. 5	p.71,1. 8	
BB-7	p.71,1.11	p. 71,1.11	p.71,1.13	
BB-8	p.71,1.17	p. 71,1.17	p.71,1.19	
BB-9	p.71,1.22	p. 71,1.22	p.71,1.24	
BC	p.60,1. 7	p. 60,1. 7	p.60,1.11	
BC-1	p.60,1.15	p. 60,1.15	p.60,1.19	
BC-2	p.60,1.23	p. 60,1.23	p.61,1. 2	
BC-3	p.61,1. 6	p. 61,1. 6	p.61,1.10	
BC-4	p.61,1.14	p. 61,1.14	p.61,1.18	
BC-5	p.72,1. 4	p. 72,1. 4	p.72,1. 6	
BC-6	p.72,1.10	p. 72,1.10	p.72,1.12	
BC-7	p.72,1.16	p. 72,1.16	p.72,1.18	
BC-8	p.72,1.21	p. 72,1.21	p.72,1.23	
BC-9	p.73,1. 1	p. 73,1. 1	p.73,1. 3	
BD	p.62,1. 1	p. 61,1.22	p.62,1.19	
BE	p.62,1.23	p. 62,1.23	p.63,1.16	
BF	p.63,1.20	p. 63,1.20	p.64,1. 7	
BF-1	p.64,1.11	p. 64,1.11	p.64,1.15	
BF-2	p.64,1.19	p. 64,1.19	p.64,1.22	
BF-3	p.64,1.25	p. 64,1.25	p.65,1. 3	
BF-4	p.65,1. 7	p. 65,1. 7	p.65,1.10	
BG	p.65,1.14	p. 65,1.14	p.65,1.18	
BH	p.65,1.22	p. 65,1.22	p.65,1.24	
BI	p.68,1.24	p. 66,1. 1	p.69,1.16	

No. 18642  
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FOR THE NINTH CIRCUIT

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MILES CONSTRUCTION CORP.

*Appellant,*

*vs.*

HELEN H. DEMPSTER, *et al.*,

*Appellees.*

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**APPELLEE'S BRIEF.**

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**APPELLEE'S BRIEF.**

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**Statement of the Case.**

On October 8, 1956, one A. T. Locke entered into a written agreement with the appellant, Miles Construction Corporation, whereby the said A. T. Locke contracted to perform certain services for Miles Construction Corporation as a bidder or estimator and to prepare bids or estimates for bids for use by Miles Construction Corporation in the Capehart Housing program (Title 8 of the National Housing Act). [Great American Ex. AA.] Thereafter, A. T. Locke assigned one half of his interest under said agreement to one John Sherman. [Great American Ex. AB] and subsequently, John Sherman and A. T. Locke entered into a further written agreement with the appellant by which certain terms of the agreement of October 8, 1956, were amended. [Great American Ex. AC.]

In its opening brief the appellant concedes that A. T. Locke prepared for appellant estimates for bids for the Little Rock Capehart Housing Project in Little Rock, Arkansas, and that appellant, Miles Construction Corporation, became the lowest acceptable bidder upon said project, entered into the performance thereof, and completed construction in or about May 13, 1960. (Appellant's Op. Br. pp. 6-8 incl.)

In accordance with the agreement of October 8, 1956, as amended, compensation became payable to A. T. Locke and John M. Sherman. The paragraphs of the agreement of October 8, 1956, as amended, pertaining to the compensation payable are as follows and are contained in Paragraphs 11 and 12.

“11. In the event that Miles is the successful bidder, and in the event that Miles and its principals elect to accept the said contract, as consideration for performance by Locke hereunder, and subject to the faithful performance by Locke of all of the terms and conditions thereof, Miles shall pay to Locke the sum of \$100,000.00 if, but only if, the ‘net return,’ as said term is hereinafter defined, to Miles, resulting from the bidding, entering into, and performance by Miles of a Contract on any of the said Projects is at least three per cent (3%), but less than six per cent (6%), of the total amount of the Contract between Miles and the United States Government; or, if, but only if, the said ‘net return’ to Miles is six per cent (6%) or more, of the said Contract amount, Miles shall pay to Locke the sum of \$150,000.00. Provided, however, that there shall be deducted from any sum payable under this paragraph any



amount which Miles shall have theretofore paid to Locke on account of bidding expense, or otherwise. The said sum shall be payable only in the event that Miles actually enters into a Contract with the Federal Housing Administration and the Department of the Army covering any of the said Projects, and fully performs and completes the said Contract. Said sum shall be payable only after performance, completion, and acceptance of work under said Contract, and only after Miles has received full and final payment under said Contract, or any additions or supplements thereto. Said payment shall be due on or before thirty (30) days after the date on which Miles receives final payment under the said Contract, or any additions or supplements thereto, or the date on which Miles has paid all costs and expenses incident to the performance of said Contract, or the date on which Miles has ascertained, by proper accounting procedures, the amount which would, by this Agreement, be the 'net return,' whichever is the later date." [Par. 15, Findings of Fact; Great American Exs. AA and AC.]

"12. The term 'net return,' as used in the preceding paragraph, is hereby defined to mean the amount by which the total receipts of Miles under the said Contract exceed the aggregate of the cost of all labor, materials, and services expended or incurred in bidding the said Project, performing all acts necessary or appropriate to accomplish the construction, and closing with the Federal Housing Administration and the Department of the Air Force, actual construction, fi-

nancing costs and expenses, and any and all other costs, expenses, charges, fees, taxes (except Federal and State income taxes), deposits, bond premiums, and traveling and other expenses of any nature whatsoever expended or incurred in connection with such project. Without limiting the foregoing, there is specifically included in 'cost,' as used herein, a sum equal to  $2\frac{1}{2}$  of all other costs paid, expended, or incurred in connection with the said Project. The term 'net return' shall, for the purposes of this Agreement, be construed as being the amount by which such receipts exceed the costs, before the payment, or setting aside for payment, or any of the following:

(a) Any management or contractor's fee to any of the participants of Miles, except to the extent that any such participant is paid from the said 2% ;

(b) Any central office overhead and supervision to any participant of Miles, except to the extent that any such participant is paid from the said 2% ;

(c) Any fee to any of the participants of Miles for providing indemnification on bond of Miles, except to the extent that any such participant is paid from the said 2% ;

(d) Any fee to any of the participants of Miles providing or arranging financing, or for providing working capital, except to the extent that any such participant is paid from the said 2% ;

(e) Any subcontractor's profit to any participant of Miles except to the extent that any such participant is paid from the said 2% ; and

(f) Any salaries to officers or Directors of Miles who are not actually on the job during construction, and carried on the job payroll of Miles, except to the extent that any of them is paid from the said 2%.” [Par. 16, Findings of Fact, Great American Exs. AA and AC.]

The total amount of the contract between Miles Construction Corporation and the United States Government was established by the answers by Miles Construction Corporation to interrogatories propounded by appellee, Great American Insurance Company.

The interrogatory and answer were as follows:

“Q. What was the total gross amount of the contract or contracts, including all amendments, additions, and supplements thereto, entered into by Miles-Fairfax, Miles-Hawthorne, Miles-Naylor, Miles-Hendry, and Miles-Layden, joint ventures, hereinafter referred to collectively as ‘Miles’ for the construction of the Capehart Housing Project, exclusive of offsite work, at Little Rock Air Force Base, Jacksonville, Arkansas? A. \$22,611,439.58 is the total amount for the Capehart Housing Projects. Offsite work was not a part of the Capehart Housing Project, and was not performed by any of the joint ventures named in this interrogatory.” [Rep. Tr. p. 146, line 20, to p. 147, line 10.]

Full and final payment of the contract amount was made by the United States to Miles on May 13, 1960. [Rep. Tr. p. 147, lines 11-16 incl.]

The total gross income or total receipts of Miles under the construction contracts equaled the contract amount and was established by the answers of Miles to interrogatories propounded by Great American Insurance Company as follows:

“Interrogatory No. 7. Q. Was the total gross income of Miles in connection with the Capehart Housing Project the sum of \$22,611,439.58? If your answer is in the negative, state the actual total gross income and explain why said sum is greater or less than the sum of \$22,611.439.58. A. The total gross income of Miles in connection with the Capehart Housing Projects was \$22,-611,439.58. Miles had certain interest income which was not gross income in connection with the Capehart Housing Projects, and which is detailed in answer to Interrogatory No. 10 below.” [Rep. Tr. p. 148, lines 6-18 incl.]

“8. Q. What were the total receipts by Miles under the Capehart Housing contracts? If said sum is less than the total gross income of Miles, state what deductions are made by Miles to reduce the total income to contract income and the amount of each such deduction. A. The total receipts from the Government by Miles under the Capehart Housing contracts was \$22,611.439.58.” [Rep. Tr. p. 201, lines 9-18 incl.]

By its answers to interrogatories Miles Construction Corporation conceded that the total of all costs under the agreement of October 8, 1956, as amended, inclusive of the sum of \$100,000.00 as Miles Construction Corporation's claim of the fee payable to



A. T. Locke, was not greater than \$20,883.505.81 and was established as follows:

“Interrogatory No. 22. Q. Does Miles, in its calculation of net return under the agreement of October 8, 1956, as amended, include as a cost of construction the sum of \$100,000 as the fee to Locke under said agreement? A. Yes.

Interrogatory No. 23. Q. What sum does Miles compute as the base total of all costs under the agreement of October 8, 1956, as amended, before any inclusion of 2 percent thereof as additional cost as provided in the agreements? A. \$20,883.505.81 (including costs and expenses for the year 1961.)” [Rep. Tr. p. 149, lines 2-15 incl.]

Total base cost exclusive of any allowance for a fee under the agreements of October 8, 1956, as amended, were established by the following interrogatories as answers:

“Interrogatory No. 29. Q. Based upon the answer to Interrogatory No. 23, what is the total base cost, prior to an allowance of 2% thereof, under said agreements, exclusive of an allowance for the fee payable under said agreements? A. \$20,783.505.83.” [Rep. Tr. p. 150, lines 15-21 incl.]

As the court will note, the agreement of October 8, 1956, as amended, provides that in the calculation of net return under Paragraph 12 there must be deducted a sum equal to 2% of the actual cost. This figure



was calculated by Miles and was established by the following interrogatory and answer:

“Interrogatory No. 25. Q. The agreement of October 8, 1956, provides that there shall be deducted as cost, in arriving at net return, 2 percent of all costs. What sum has Miles determined as 2 percent of all costs? A. \$417,670.12.” [Rep. Tr. p. 149, lines 16-21 incl.]

The figure of 2% of all costs calculated on costs exclusive of the \$100,000.00 allowance for the fee of A. T. Locke and based upon the answer to Interrogatory No. 29 is as follows:

$$\$20,783,505.81 \times 2\% = \$415,670.12.$$

Net return under the agreement of October 8, 1956, as amended, as calculated by Miles Construction Corporation with the inclusion as a cost of the fee payable under the agreement was established by the following interrogatories and answers:

“Interrogatory No. 26. Q. What sum has Miles calculated as net return under the agreement of October 8, 1956, as amended? A. \$1,310,263.63.

Interrogatory No. 27. Q. What percentage has Miles determined as the net return upon the Capehart housing contracts as provided in the agreement of October 8, 1956, as amended? A. 5.795 percent. This percentage has been adjusted from that previously furnished to parties to this action by reason of the 1961 operating loss, the amount of which was not known at the time the previous percentage was furnished.” [Rep. Tr. p. 149, lines 22-25 incl., and p. 150, lines 1-11 incl.]

The net return under the agreement of October 8, 1956, as amended, exclusive of any fee included therein as a cost is calculated as follows:

Contract Price and Total Receipts:	\$22,611,439.58	
Less: Total Costs	\$20,783,505.81	
2% of total costs	415,670.12	
		<u>21,199,175.93</u>
		<u>\$ 1,412,263.65</u>

Net return: \$1,412,263.65 : \$22,611,439.58 = 6.25%

Accordingly, under the calculation of Miles Construction Corporation with the inclusion of the fee to be calculated as an item of cost in the calculation the base fee payable under the agreement of October 8, 1956, as amended, was claimed to be \$100,000.00. The District Court determined that the fee payable under the agreement could not be included in the calculation of the fee and that, accordingly, the base fee payable under the agreement was \$150,000.00.

Prior to the institution of the action, \$15,000.00 was paid by Miles Construction Corporation to A. T. Locke and, accordingly, the court determined the net amount payable under the agreement to be the sum of \$135,000.00.

Prior to the commencement of this action, A. T. Locke and John M. Sherman made various assignments of their interest in the fee payable under the agreements. These assignments are set forth in Paragraphs 6, 8, 9, 10, and 11 of the Findings of Fact

and are not contested here by Appellant. (Appellant's Op. Br. pp. 14 and 15.)

Miles Construction Corporation appeals from the judgment of the District Court so far as it awards to the assignees of A. T. Locke a sum in excess of \$85,000.00. In this connection, the appellee, Great American Insurance Company, concedes that the assignees described in the Findings of Facts referred to are possessed of assignments prior to the assignment of Great American Insurance Company and that, accordingly, it is the only party affected by this portion of the appeal. [Finding of Fact, Par. 12.] Miles Construction Corporation further appeals from that portion of the judgment which awards interest to the various assignees and the appellee, Great American Insurance Company, submits this brief on its own behalf and on the remaining appellees affected by this portion of the appeal.

Except as herein noted, appellee, Great American Insurance Company, accepts the statement of the case set forth by appellant, Miles Construction Corporation, save and except where argument is inserted therein as the conclusions of appellant.

## ARGUMENT.

### I.

#### Introduction.

The issues presented by appellant are twofold: First, whether or not in the calculation of a fee to be determined upon a percentage of net return, that is a percentage of the net results of receipts over expenses, the fee to be determined should as a matter of logic or law be included as an expense in the calculation. Second, whether or not interest under the agreement of October 8, 1956, as amended, became payable on or before 30 days after the date when Miles Construction Company received the final payment under its construction contract with the United States.

Inasmuch as Miles Construction Corporation concedes that its remaining assignments of error do not require a reversal (presuming but not conceding that the assignments are well taken) the appellee deems said assignments waived and no argument is presented herein on such issues.

### II.

**As a Matter of Law and Logic, in the Calculation of a Fee Dependent Upon a Percentage of Net Return, That Is the Excess of Receipts Over Expenses, No Deduction May Be Made on Account of the Fee to Be Paid. To Construe Any Agreement, Therefore, to the Contrary Would Result in an Absurdity.**

The written agreements in question, being in particular the agreement of October 8, 1956, as amended by the agreement of December 27, 1956, provide that A. T. Locke will receive a fee or commission determined by the net return realized by Miles Construc-

tion Corporation. Paragraph 11 provides that if the net return is at least 3% but less than 6% of the total amount of the contract between Miles and the United States, A. T. Locke shall receive a fee or commission of \$100,000.00, and if the net return to Miles is 6% or more, then Locke shall receive a fee of \$150,000.00. Paragraph 12, as amended, provides that net return is defined as the amount by which the total receipts of Miles "exceed the aggregate of the cost of all labor, materials and services expended or incurred in bidding the said project, performing all acts necessary or appropriate to accomplish construction, and closing with the Federal Housing Administration and the Department of the Air Force, actual construction financing costs and expenses, and any and all other costs, expenses, charges, fees, taxes, (except Federal and State Income Taxes) deposits, bond premiums, travelling and other expenses of any nature whatsoever expended or incurred in connection with such project."

The question presented to the court is whether or not under the terms and provisions of the agreement of the parties there should be included as a cost or expense in the calculation of net return the fee or commission earned by the said A. T. Locke, and it is the position of Miles Construction Corporation that in the determination of a commission based upon a percentage of net return, there must be included in the calculation of the net return the very commission to be calculated. The utter absurdity of the position is obvious. Thus, for example, suppose that the net return earned were such that the inclusion of the fee of \$100,000.00 as a cost resulted in a net return in excess of 6%, whereas the inclusion of a fee of \$150,000 as a cost



resulted in a net return of less than 6%. If the net return were in excess of 6%, the payee would be entitled to \$150,000, but the inclusion of that \$150,000 reduces the net return to less than 6% thereby reducing the fee to \$100,000 but that in turn creates a return in excess of 6% and a fee of \$150,000 and so on in endless circle of reasoning. Such a situation could not possibly be resolved by judicial authority and its very impossibility illustrates the unsound construction urged by Miles Construction Corporation. This result, it is noted, is achieved in any attempt to include, in the calculation of a contingent fee or commission, the commission itself to be paid. We know of no rule of law which would require this court to give a legal document a ridiculous, absurd, and impossible construction.

Miles Construction Corporation has failed to submit one single case which would support the strange construction which it now urges upon this court, and we are frank to state that our research has failed to disclose any such case. The obvious weight of judicial authority is to the contrary and a review of pertinent decisions is as follows:

In the case of *Shields v. Rancho Buena Ventura*, 187 Cal. 569, the plaintiff had entered into an agreement with the defendant whereby he agreed that he would manage the defendant's ranch and that if sufficient net profits were realized for such payment he would receive the sum of \$1,500.00 per year. His agreement provided that in the determination of these profits there should be deducted "all expenses incurred in the management of the ranch, including the household and living expenses of himself and family."

(Page 371.) The plaintiff brought an action for the agreed sum urging that sufficient funds had been earned so as to entitle him to the fee. In its consideration of the case, the court examined the accounts and noted that the commission item had been entered as an expense in the determination of profits as accrued for payment. In the determination of whether sufficient profits had been made to entitle the plaintiff to the recovery he sought, the Supreme Court of California specifically held that the commission items accrued had to be eliminated as expenses and were not to be considered in the determination of whether or not sufficient profits had been made (page 575) and affirmed judgment rendered for the plaintiff.

In the case of *Bishop v. Kelley*, 100 Cal. App. 2d 775, a case remarkably similar to the instant case, the defendant, an estimator, had a written contract whereby he would receive from the plaintiff, general contractor, a stated salary plus 25% of the net profits of work bid by the plaintiffs as a general contractor. The matter was referred to a referee to take an account of the net profits. In its definition of what the referee was to consider as net profits (page 781) it is significant to note that the court did not require that the commission should be deducted from the profits in order to determine the amount to which the defendant was entitled but provided only for deduction of the actual salary that was paid to him. Upon appeal, and although reversed on another point, this particular reference to the referee was affirmed by the court.

Other California cases involving a percentage of profits as compensation in which the court makes no deduction in arriving at net profits because of the

compensation which would be payable are *Kales v. Houghton*, 190 Cal. 294; *Bernstein v. Sirotta*, 213 Cal. 21; and *Boradori v. Peterson*, 86 Cal. App. 753.

In addition to applicable California authorities, there are pertinent Federal decisions.

In the case of *Rogers v. Hill*, 289 U. S. 582, the corporate bylaws authorized the corporation to pay its officers a certain percentage of its profits as compensation. The plaintiff contended that the bylaw was invalid since the charter provided that all profits should be applied to the acquisition of property and the payment of dividends. In its decision, the court pointed out that the term net profits, as used in the bylaw in question, included as the profit the commission or salary payable to the officer; i.e., that such was not deductible in the determination of net profits to determine their commissions, and that the term net profits as used in the charter did not include as profit the commission paid to the officers but was the resultant net profit after such payment.

In the case of *Winkleman v. General Motors Corporation*, 44 Fed. Supp. 960, the court was called on to determine whether a bonus should be included as an expense in the calculation of net earnings under a bonus plan. The court pointed out that the agreement in question contained no express provision for the inclusion of the bonus as an item of expense in the calculation of net earnings and stated "I think it was reasonable not to include in the course of the calculations, the very item to be determined" . . . "it is contrary to the concept of profit sharing to have any part of the bonus charged against the recipients share

of the profits.” (Page 1,000.) The court further quoted applicable authorities as follows: “Considered in the light of ordinary practical business experience, it would be unreasonable in ascertaining the amount of net profits or net earnings to include the bonus beneficiaries share as part of the expense of the concern,” (page 1,000), citing *Selz v. Buell*, 105 Ill. 122, 130; *Briggs v. Groves*, 9 N. Y. S. 765, 30 N. E. 865; *Holmes v. James Buckley & Co.*, 165 La. 874, 166 So. 219, 221; *Epstein v. Schenck*, 35 N. Y. S. 2d 969; and *Rogers v. Hill*, 289 U. S. 582.

Numerous cases are annotated in 49 A. L. R. 2d 1136. The head note to the annotation reads:

“The amount of the bonus or extra incentive compensation paid to the bonus recipient should not upon the grounds that it is repugnant to the purposes of the benefit to permit such charge to be deducted as an expense in calculating a corporate employers net profit earnings, as the base for computing such benefit.”

In the interpretation of the written agreements in question, the following sections of the California Civil Code are applicable:

Section 1636—

“A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful.”

Section 1638—

“The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity.”



Section 1643—

“A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties.”

Section 1653—

“Words in a contract which are wholly inconsistent with its nature, or with the main intention of the parties, are to be rejected.”

Section 1654—

“In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist. The promisor is presumed to be such party; except in a contract between a public officer or body, as such, and a private party, in which it is presumed that all uncertainty was caused by the private party.”

In its opening brief, appellant would seem to contend that *Bishop v. Kelly, supra*, and *Winkleman v. General Motors, supra*, support the position assumed by it. It is respectfully submitted that these cases together with the other cases heretofore cited support the general principal that it is repugnant to the very meaning of a fee determined upon the basis of net return to include as an expence the very fee to be calculated for its logically impossible and results in an infinite number incapable of calculation.

So that there may be no question on the point, the court's attention is respectfully invited to the fact that the mere accrual by Miles of the fee payable under



the agreements does not pursue classify such fee as an expense. *Iowa So. Utilities Co. v. Cassill*, 69 F. 2d 703, 706.

In addition to the foregoing, the court's attention is respectfully invited to the interpretation placed by Miles Construction Corporation upon the agreements in question. In its certificates to the contract renegotiation board as required by Title 50, Section 1215-(e) (1) U. S. C., Miles Construction Corporation certified that the amount payable to A. T. Locke under the agreements was \$135,000. [Rep. Tr. p. 153, lines 23-25, p. 159, lines 1-5, and lines 22-25, and p. 155, lines 1-11.] At no time did Miles inform the contract renegotiation board that any sum less than \$135,000 was payable under the agreements.

In its tax returns to the United States, Miles set forth a liability to A. T. Locke in the sum of \$135,000. [Rep. Tr. p. 78, line 13, to p. 79, line 21.]

On September 1, 1960, Miles purchased \$135,000 in United States treasury bills to provide for the payment of the fee under the agreements. [Rep. Tr. p. 150, line 22, to p. 151, line 4.] Finally, Miles Construction Corporation carried on its books and records a liability to A. T. Locke of \$150,000 (to which, of course, there was a credit of \$15,000 previously paid). [Rep. Tr. p. 99, lines 1-9 incl.] Not until the commencement of the instant action was Miles' position any other than that \$135,000 was payable under the agreements. [Rep. Tr. p. 99, lines 10-25 incl.]

From the appellant's opening brief it would appear to be the position of Miles that since the fee under the agreement amounts to \$135,000 the within judgment

results in a net return to Miles of less than 6%. We cannot see where the agreement is susceptible to such interpretation. The agreement in question was prepared by Miles Construction Corporation [Rep. Tr. p. 13, lines 15-23 incl.] and any ambiguity therein is construed against Miles Construction Corporation. Section 1654 California Civil Code. The absurdity of the position of Miles is illustrated by its own argument for in the event that the fee to Locke under the agreements even though unpaid is included as an expense it results in a net return in excess of 6% only upon rendition of judgment herein is the sum to be paid. This results in an effective net return to Miles in excess of 6% at the present time and under the express terms of the agreement the sum of \$150,000 therefore becomes payable.

### III.

#### **Miles Construction Corporation Incorrectly Concludes That Total Receipts of Miles Under the Agreements Were Other Than Contract Payments to Miles From the United States Government.**

In Section 4 of its opening brief (commencing page 36) appellant argues that amounts received through litigation subsequent to May 13, 1960, affect the calculation of the fee under the agreements. This is clearly incorrect. Paragraph 12 of the agreements provides that net return is the amount by which "total receipts . . . under the contract" exceed the aggregate of all costs. Total receipts under the contract were and are as admitted and conceded by Miles to be the total sum paid by the government to Miles Construction Corporation in the sum of \$22,611,439.58. [Rep. Tr. p. 201, lines 9-18 incl.]

The expenses authorized in determining net return are by Paragraph 12 defined as expenses “of any nature whatsoever expended or incurred in connection with such project.”

By its answers to interrogatories Miles Construction Corporation conceded that no construction costs or expenses in connection with the project were paid or incurred after December 31, 1960 and that such construction costs were \$20,504,090.61. [Rep. Tr. p. 148, line 19, to p. 149, line 1.]

Thus it is noted that although Miles states that substantial sums were recovered by it through litigations, no such recovery is utilized by Miles as increasing total receipts under the contract as defined in Paragraph 12 of the agreement.

#### IV.

#### **The District Court Correctly Held That Interest Was Payable Under the Agreement From and After 30 Days After Final Payment Was Received by Miles From the United States.**

The agreement of October 8, 1956, as amended, provides that payment thereunder shall be due on or before 30 days after the latter occurrence of the following events:

1. Final payment from the government,
2. Final payment of “all costs and expenses incident to the performance of said contract,” or
3. The date upon which Miles determines by proper accounting procedures net return under the agreement.

Clearly upon ascertainment of total income and total expenses, net return is capable of calculation and it, therefore, follows that the appellant could not by its

unilateral action refuse to calculate net return so as to extend the time for payment. *United States v. Peck*, 102 U. S. 64, *Van Duskin v. Kuhns*, 164 Cal. 472.

The court may note that in the usual course of practice the United States does not pay final payment under a contract until all costs and expenses of the contractor have been certified to as paid and in the usual course of events total expenses would be known prior to final payment by the government. Miles Construction Corporation contends that this second provision of the agreement is applicable and yet it fails to illustrate one single expense paid after May 13, 1960.

Illustrative of the position taken by Miles Construction Corporation is this subject of the calculation of net return. Although Miles contended, even at trial, that it was incapable of calculating net return the evidence established that such a calculation had been made on prior occasions. [Rep. Tr. p. 151, lines 5-16 incl.]

In the action, Miles Construction Corporation took the position that the only costs and expenses unpaid were attorneys fees, court costs incident to uncompleted litigation, and the amount which the court might adjudge payable in this action [Rep. Tr. p. 200, line 12, to p. 201, line 1] asserting that no interest whatsoever was due for the reason that the fee payable under the agreement was an expense and consequently all expenses had not been paid. In its lack of candor to the court, the responsibility lies with the appellant. It is submitted that costs and expenses "incident to the performance of the contract" are not the attorneys fees and costs involved in independent litigation and that to construe such expenses or general office overhead as expenses incident to the performance of a contract



would be improper for the reason that after May 13, 1960, the contract had been performed, final payment received, and it would be impossible for Miles to pay costs for such performance thereafter. Accordingly, the interest award from and after 30 days after May 13, 1960, the date when final payment was received, (June 13, 1960) was eminently proper.

It is submitted that the fact that the contract might possibly have been renegotiated in that it involves only a possibility did not and does not constitute grounds for the refusal by Miles to calculate net return.

### Conclusion.

Appellee respectfully submits that the judgment of the District Court was clearly proper and correct. The agreements involved were drawn by Miles Construction Corporation through its attorneys and said agreements do not provide for the construction urged by appellant. Clearly were it the intent of the agreements to provide that the fee should be determined as a cost in calculating net return, it would be specifically set forth to that effect and similarly if the date of payment were to await the pleasure of appellant for many years while it engaged in litigation, it would be necessary that the agreements so provide.

For the reasons stated, Appellee respectfully requests that the judgment be affirmed.

Respectfully submitted,

ANDERSON, MCPHARLIN & CONNERS,  
*Attorneys for Appellee, Great  
American Insurance Company.*



### **Certificate.**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

LUTHER L. JENSEN



No. 18642

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

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MILES CONSTRUCTION CORP.,

*Appellant,*

*vs.*

HELEN H. DEMPSTER, *et al.*,

*Appellees.*

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## APPELLANT'S REPLY BRIEF.

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FILED

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## APPELLANT'S REPLY BRIEF.

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### Appellant's Statement of the Case.

Parenthetically, we call attention to the following typographical errors in Appellee's quotations from the Agreement of October 8, 1956, as amended, and from Interrogatories and Answers: "Thereof" should read "hereof" in the sixth line of the quotation from Paragraph 11 on page 2; "2-1/2" should read "2%" in the eighth line on page 4; "and" should read "or" in the first line of Subparagraph (b) on page 4; "bond" should read "bonds" in the second line of Subparagraph 3 on page 4; the word "for" should be inserted at the end of the first line in Subparagraph (d) on page 4; the first "the" in the fifth line of Interrogatory 8 on page 6 should be deleted; and "rerurn" in the third line of Interrogatory 25 should read "return." (Other minor typographical errors have been ignored.)

Our principal quarrel with Appellee's statement of the case is that its quotation of Interrogatories and An-

swers out of context in several instances is, or may be, confusing, and thereby do, or may, lend some undue support to arguments made later in Appellee's Brief.

It is undisputed, of course, that the total receipts *from the Government* on the Capehart housing projects at Little Rock Air Force Base were \$22,611,439.58.

However, at the bottom of page 6 and the top of page 7, Appellee apparently seeks to set the stage for an invalid argument that Miles has conceded that all costs under the Agreement of October 8, 1956, as amended, including the \$100,000.00 payable to Locke, were not greater than \$20,883,505.81 *at any time*. This premise is not supported by the record, whether reference is had to the interrogatories or otherwise. The record shows that the interrogatories were propounded and answered shortly prior to the trial, in 1962, and include all *adjustments* which were made through the year 1961. Therefore, when, in answer to Interrogatory No. 23, Miles computed "the base total of all costs under the agreement of October 8, 1956, as amended, before any inclusion of 2 percent thereof as additional cost as provided in the agreements" at \$20,883,505.81, it was not in any sense "conceding" that *at no point* in the performance of the Contract had the costs laid out been greater than this amount. The same applies to the answer to Interrogatory No. 29.

The computation of net return in which Appellee engages at the top of page 9 likewise is not factual, but argumentative, and has a tendency to confuse the issue. What Appellee has done here is to take the 1962 figure of costs, exclusive of the 2% of other costs, in

the amount of \$20,883,505.81, has deducted from it \$100,000.00, has added to it 2% of other costs, and thus arrived at \$1,412,263.65 as net return and reaches the conclusion that net return was 0.25%. The arithmetic is good, but the premise is faulty, in that it begs the real issue here under consideration.

Actually, the facts are undisputed that, prior to the crediting of the recovery on account of the J.E.H. Construction Associates-New Amsterdam Casualty Company matter, amounting to \$316,792.51, Miles' costs (including \$150,000.00 accrued on its books in connection with the October 8, 1956, Agreement, as amended) was \$21,659,500.12 [Ex. BI]. Thus, even if the entire \$150,000.00 plus \$19,462.95, as adjustment on off-site overhead, are *deducted* from this figure, actual *costs expended* remained at \$21,490,037.17, yielding net return of \$1,121,402.42, which is less than 6%.

If we read Appellee's Brief correctly, it is attempting to contend that Miles, in some way, through the answers to its interrogatories, has foreclosed the question of consideration of the substantial costs which Miles expended, and for which it was partially reimbursed through the J.E.H.-New Amsterdam recovery. Such is clearly not the case.

In truth, the costs were, as shown by Exhibit BI, at one point \$316,792.51 *higher* than they were after the J.E.H.-New Amsterdam recovery was effected and credited, and, only after making all appropriate and relevant adjustments, was the figure set forth in the Answers to Interrogatories Nos. 23 and 29 arrived at.

## REPLY TO APPELLEE'S ARGUMENTS.

### I.

#### Introduction.

As is the case throughout Appellee's argument, its statement of the issues here is a vast over-simplification, and, therefore, an erroneous statement, of them. We respectfully refer the Court to the Summary, commencing at page 21 of our Opening Brief, for what we believe to be a correct statement of the issues.

#### Reply to Appellee's Argument II.

In its pristine form, that which Appellee is saying is that where two or more parties agree to dividing *profits* upon a percentage basis, it would be illogical, and, therefore, absurd, first so to divide the profits, and then deduct one party's share of the profits so divided as an "expense" in arriving at the amount to be paid to that party. We agree.

However, Appellee apparently has misled itself into believing that this is the nature of the Agreement which is the subject of this litigation. This is *not* an Agreement calling for a percentage division of net profits. Quite the contrary. It is an Agreement which calls for the payment of \$100,000.00 if net return to Miles is 3%, or more, and, if net return to Miles is 6%, or more, it calls for the payment of \$150,000.00.

We submit that the paragraph of Appellee's Argument commencing at the middle of page 12, and running to the middle of page 13, of its Brief, begs the basic question, and, in doing so, utterly fails to support Appellee's conclusion that Miles' contended for construction of the Agreement is absurd or illogical. Appellee suggests that we "suppose" that the net return earned were such that the inclusion of the fee of \$100,000.00 as a cost resulted in a net return in excess of



6%. This supposition is speculative, and the question which it poses need not be reached in deciding this appeal. However, our position and our argument clearly do not suggest the “endless circle reasoning” answer which Appellee puts forth. Clearly, a literal reading of the Agreement, saying, as it does, that “if, but only if” the net return to Miles is 6% shall Locke receive \$150,000.00, would render tenable, if not irrefutable, the argument that Locke would be entitled to more than \$100,000.00 only after there had been set aside for Miles a full 6% in net return, and, if the excess were less than \$50,000.00, Locke would get only this excess. In any event, however, it is perfectly clear that if once “net return,” by whatever process of computation, passes 3%, at least \$100,000.00 on account of the Agreement must be added to costs, if not already there, before resolving the next question as to whether Locke is entitled to more; that, at the very minimum, this \$100,000.00 must remain and be considered a part of cost in determining whether net return is more or less than 6%; and that, only if this projected a net return of 6%, or more, would Locke be entitled to either (a) \$50,000.00 more, or (b) such portion of it as remained after crediting to Miles a full 6% called for by the Agreement, depending upon how this preliminary (but here moot) question was resolved.

Appellee makes no effort whatsoever to answer Appellant’s argument that, once it becomes established that at least \$100,000.00 is payable under the Agreement, this must be added to costs and expenses in determining net return, for the purpose of ascertaining whether or not more than \$100,000.00 is payable. Instead, Appellee relies on cases so vastly different on their facts, and as to which one must strain to find any inference which arguably could support Appellee’s position.

Appellee first leans heavily on *Shields v. Rancho Buena Ventura*, 187 Cal. 569, 203 Pac. 114. A careful reading of this case, together with the same case when it was previously on appeal, *Shields v. Rancho Buena Ventura*, 38 Cal. App. 696, 177 Pac. 499, demonstrates how tenuous is Appellee's argument that it controls, or is even helpful in the case at bar. As an analysis of these two Opinions requires a rather extensive quotation from them, we are placing this analysis in the Appendix.

Appellee's statement at the top of page 14 of its Brief is an erroneous one of what the Court held. At page 575, the Court was determining that, upon a balancing of credits and debits, plaintiff was entitled to *reimbursement* for \$1,492.52 invested by him in the project. The Court referred to eliminating certain items, including salary accrued but not paid, only in the context of confirming plaintiff's right to reimbursement.

Except for the lonely sentence, referred to out of context by Appellee, and, in fact, not constituting any "holding", as asserted by Appellee, both Opinions, and all of their implications, are devoid of anything lending comfort to Appellee's position; on the contrary, the two Opinions, when read both together and separately, support the Appellant's position, for, if any logical parallel is to be drawn between the facts and the holdings in these Opinions, and the facts and the decision of the District Court in the case at bar, it is that *Shields* (the plaintiff) is in a somewhat similar position to *Miles* in the case at bar. *Shields* was to receive the *first* \$1,500.00 per year of the excess of receipts over expenditures, and the defendant was to receive anything which remained. In the case at bar, *Miles* was to receive 3% of Contract receipts; after 3% had been set aside to *Miles*, *Locke* was to receive \$100,000.00. Thereafter, *Miles* was to receive an additional 3% of Contract receipts, and only after it had received such ad-

ditional 3% was Locke to be entitled to an additional \$50,000.00.

Again, Appellee relies heavily on *Bishop v. Kelley*, 100 Cal. App. 2d 775, 224 P. 2d 814. An analysis of this opinion likewise demonstrates that Appellee's reliance upon it is not only misplaced, but that, if it has any teaching, it confirms the position of the Appellant in the case at bar. There, the defendant, Kelley, was to receive a salary and 25% of all net profits on all jobs. The trial Court laid down the rules under which the referee was to take an account between the parties, and provided that such account was to consider, as a liability, among other things, “. . . the salary paid to defendant . . .”. (Italics added.) By implication, at least, the Court approved the portion of the order of reference requiring the accrual of salary paid to the plaintiff before computing the profit to be divided 25% to Kelley and the remainder to Bishop.

If *Bishop* has any similarity to the case at bar, and if its implied holding is of any assistance here, it is that the salary paid to, or accruable to, the account of Kelley is, like the first \$100,000.00, payable under the Agreement in the case at bar, when Miles was shown to have realized a net return of 3% of Contract receipts, properly to be accrued before determining, in *Bishop*, the number of dollars, if any, to which Kelley was entitled under a division of the profits, and, in the case at bar, the question as to whether Locke was entitled to anything in excess of that first \$100,000.00.

Appellee has failed to favor the Court with any explanation as to how, and in what manner, *Kales v. Houghton*, 190 Cal. 294, 212 Pac. 21; *Bernstein v. Sirotta*, 213 Cal. 21, 1 P. 2d 8; or *Boradori v. Peterson*, 86 Cal. App. 753, 261 Pac. 520, have any bearing, or are of any assistance in the case at bar. (Appellee, also,

it is noted, has failed to follow here, as in all other citations to California cases, the rules of this Court, that citations are to include National Reporter System citations, Rule 18.2(a).)

*Kales* involved an across the board, 50/50 profit and loss arrangement. The similarity between it and the case at bar is absolutely non-existent, and it provides no help.

*Bernstein* does not help the Appellee, but is apposite as to the Appellant. There the plaintiff was to receive \$10,200.00 in cash in semi-monthly installments of \$212.50, and 20% of the net annual earnings. The clear implication is that this "salary" (like the initial \$100,000.00 after 3% of Contract receipts is set aside for Miles in the case at bar) was recognized as being considered an expense before determination of plaintiff's further share of the profits.

*Boradori* also is apposite as to Appellant's position. The \$200.00 per month salary (like the initial \$100,000.00 after 3% of Contract receipts is set aside to Miles in the case at bar) apparently was set aside as an expense before determining the plaintiff's share of the profits. Further, the rent paid by the grocery business to the employer (like the first 3% of Contract receipts in the case at bar) also was set aside before determining plaintiff's share of the profits.

*Rogers v. Hill*, 289 U. S. 582, 77 Law Ed. 1385, 53 S. Ct. 731, 88 A. L. R. 744, holds nothing more than that a provision of a bylaw was not contrary to the charter, because net profits, as used in the bylaw necessarily had a different connotation than as used in the charter. Again, this was a simple across the board profit-sharing arrangement, and again, the case, if anything, supports the Appellant's position, as obviously the regular salaries payable to officers (comparable to the



initial \$100,000.00 after 3% of Contract receipts is set aside to Miles) were deducted as expenses before arriving at the bonuses.

We have pointed out in our Opening Brief that *Winkleman v. General Motors Corporation* (D. S. C. D. N. Y.), 44 Fed. Supp. 960, is not available to support Appellee's position, but, on the contrary, supports that of Appellant. Although that Opinion is a lengthy one, it does not disclose, on its face, the precise issue which the court was determining by the language quoted by Appellee. Certainly, it was not dealing with the question as to the 7% of capital set aside before the bonuses were arrived at. Moreover, it is manifest that it was not dealing with the question which Appellee would have this Court believe to have been the question there, and that Appellee would have the Court to believe to be the question here, namely, whether or not, in an *across the board* sharing of profits, the bonus of any given officer should be added to expense in determining that officer's bonus.

Except for what we consider to be the legitimate comparison of setting aside 7% of capital from profits to the corporation with the setting aside of 3% of Contract receipts to Miles, both in the first instance, *Winkleman* otherwise is just not our case, and the language quoted does not control it.

We come now to the Annotation in 49 A. L. R. 2d 1136. Considered in the light of this Annotation as a whole, and in the light of the authorities cited in support of the quoted statement, it constitutes nothing more and nothing less than a statement of the obvious, namely, that in an *across the board profit-sharing arrangement between an employer and an employee, or employees*, the share set aside for the employees is not properly to be diluted by considering any portion of that share to be used in determining the bonus for the em-



ployee, or the employees, sharing in that pool. This is confirmed by some of the authorities which are cited for the proposition, and particularly *Winkleman, supra*.

The Annotation follows the reporting of *Harvey v. Missouri Valley Electric Co.* (Sup. Ct. of Missouri), 268 S. W. 2d 820, 49 A. L. R. 2d 1124. It is from this case that the text writer drew the language quoted by Appellee. The question there was whether or not bonuses paid for the previous year, but paid during the current year, should be deducted as an expense in arriving at the bonuses to be paid during the current year, and the court *approved* such deduction upon the basis that there had been acquiescence in this procedure. This case, therefore, does not stand as authority for the sweeping statement in the quotation, but, even if it did, as we have pointed out above, the quotation, if correct as to an across the board profit-sharing arrangement, is not applicable to the case at bar.

Appellee's reference to certain sections of the Civil Code suggests that Appellee is now taking the position that the Agreement, which is the subject matter of this case, is ambiguous, since it apparently is requesting that the Court interpret the Contract against the promisor (Miles). This is contrary to Appellee's position at the trial that, on the main issue as to the inclusion of \$100,000.00 for the purpose of determining whether or not Locke was entitled to more, the Agreement was not ambiguous. In any event, arguing that a non-ambiguous Contract should be construed against the promisor is a weak but futile reed where a litigant is attempting to induce a Court to construe an agreement contrary to its express and unequivocal language. We are somewhat puzzled by Appellee's sentence beginning at the bottom of page 17 of its Brief, and, since it is unintelligible, we must guess as to what is meant. Pre-

sumably Appellee is intending to say that the mere fact that Miles initially accrued an amount as being payable under the Agreement does not have any bearing on the amount actually payable thereunder; if so, we agree. But here we part company, because, in the very next paragraph, Appellee argues that *Miles* placed a construction upon the Agreement contrary to that for which it is now contending, and that this, in some manner, supports Appellee's position. This is such a fallacious argument as to approach frivolity. Indeed, Miles did initially accrue \$135,000.00. Under its method of accounting, and under the facts as it then knew them, it could not do otherwise. Indeed, portions of this, necessarily, were reflected in its Annual Statements filed with the Renegotiation Board. Again, this was consistent with the Rules and Regulations of the Renegotiation Board, and Miles had no other choice. Appellee then says that at no time did Miles inform the Renegotiation Board that any sum less than \$135,000.00 was payable under the Agreement. The significance of this fact is completely lost upon us. An examination of the Renegotiation Reports, which are in evidence and before the Court (see p. 14, O.B.), against the background of the Renegotiation Law and the Regulations thereunder, shows this to have no significance, Appellee well knows that it does not, and its statement appears to be calculated improperly to argue or suggest misconduct or wrongdoing on the part of Miles.

The Renegotiation Law and the Regulations permit a Government Contractor to report renegotiable business upon an annual basis which, of course, means that all renegotiable receipts in any given year are aggregated for gross renegotiation receipts, all renegotiable business costs and expenses paid or accrued are offset against such receipts, and resulting renegotiable profits are then examined, in the light of all of the cir-

cumstances, to determine whether or not they are excessive. Moreover, the law expressly provides that the accounting methods, if conforming to accepted standards, are to be accepted by the Renegotiation Board in making these annual determinations (50 U. S. C. Sec. 1213(i)).

The evidence shows, without contradiction, that Miles maintained its books and records on a percentage of completion basis; that it initially established \$135,000.00 (having no other or better means of estimating the same at its disposal); and annually offset against Contract receipts portions of this until and including the year 1959, when all thereof was so offset. The law and the Regulations provide that where renegotiable receipts in any given year are less than \$1,000,000.00, the only filing required for that year is a Statement of Non-Applicability, and that, if the Contract receipts are less than \$1,000,000.00, in any given year, the profits for that year, regardless of the amount of them, are not subject to renegotiation.

The evidence shows that in no manner could it have been determined, prior to the end of the year 1959, whether or not, by whatever manner the Contract was interpreted, that Locke would be entitled to \$85,000.00 or \$135,000.00. Therefore, by the time this question could, by any stretch of the imagination, have been determined, the facts were such that the Renegotiation Law did not require Miles to report any revision of the amount which it previously had estimated to be the amount payable under the Agreement.

In any event, so long as Miles was threatened by this litigation, with the danger of an adjudication that \$135,000.00 might thereby be determined to be payable under the Agreement, it was neither justified in revising, nor required to revise, the estimate.

The same comments, of course, apply to Appellee's argument concerning Miles' Tax Returns. The propriety of the initial accrual of this amount is not open to question, Appellee's apparent argument to the contrary notwithstanding, and, according to all sound accounting and tax principles, it should not, and cannot, be held to have been required to take back into income the \$50,000.00 differential unless and until this litigation is finally determined in Miles' favor.

Nor is any significance to be attached to the purchase by Miles of \$135,000.00 in Treasury Bills. Appellee apparently is criticizing Miles, in attempting to gain some "mileage" (no pun intended), at Miles' expense, for prudently establishing a reserve to meet a contingent liability then subject to litigation, and, at the same time, performing a function encouraged by the Treasury Department of placing these funds at a modest interest rate with the United States Government.

We need not belabor Appellee's further attempt to gain "mileage", at Miles expense, from the fact that Miles continued to carry the \$135,000.00 upon its books (adequately answered above), or Appellee's statement that "Not until the commencement of the instant action was Miles' position any other than that \$135,000.00 was payable under the agreements." Appellee, in making this argument, is fatuously suggesting, by implication, that Miles should be held to have been sufficiently clairvoyant to guess, before all of the information was at hand, that the arithmetic would work out to a gross amount of \$100,000.00, and that, having failed to do so, the decision in this case should go against it.



### Reply to Appellee's Argument III.

If we were to buy this argument with all of its implications, there would be no other conceivable conclusion than that Locke's assignees are not entitled to more than a gross of \$100,000.00, and a net of \$85,000.00.

It never has been contended, either in the trial court or here, that "Contract receipts" from the Government were anything other than \$22,611,439.58. Specifically, we have never contended that the recovery (which was well after May 13, 1960) of \$316,792.51 from the settlement of the J. E. H. Construction-New Amsterdam litigation was to be added to *Contract receipts*.

However, the evidence is unrefuted that Miles incurred very substantial costs in completing, itself, the work required to be performed by J. E. H. Construction Associates under the Subcontracts of that Subcontractor. [Ex. BF.] These costs as of May 13, 1960, stood as costs expended by Miles in connection with the performance of the Capehart projects. We always have conceded that a recovery of these costs, as well as *any other* recovery of costs previously expended at any time, are properly to be used, not by way of increasing Contract receipts (for they patently are not Contract receipts), but, we think properly go to reduce costs, and thereby, and to that extent, increase net return. Although Appellee now appears to be arguing, against itself, that this should not have been done, we feel, and always have felt, that it is proper. If we correctly read Appellee here, it is saying that Miles' answer to Interrogatory No. 11 forecloses consideration of the fact that the figure therein contained, of \$20,504,090.61, was in fact a *net* figure *after* the reduction of costs resulting from the J.E.H.-New Amsterdam recovery.

Thus, the last sentence of this argument is literally correct in stating that recovery was not utilized in in-



creasing receipts, but it is incorrect in its implication that the substantial post-May 13, 1960, recovery was not taken into account. It was taken into account by way of reduction of costs [Ex. B1], and is reflected in the figure set forth in the answer to Interrogatory No. 11.

#### **Reply to Appellee's Argument IV.**

We do not contend, and never have contended, that Miles was entitled to delay the calculation of net return beyond the time that the information was available to calculate it, and thereby delay payment. But Appellee has failed to tell us how it conceives that Miles could have computed net return as of May 13, 1960, when various contingent matters remained unsettled and undetermined, and when no recovery had been had or was available in connection with the J.E.H. Construction-New Amsterdam matter.

Appellee seems to be asking the Court to take some sort of judicial notice of what it states to be "usual course of practice" of the United States. No comment on this request appears to be necessary.

Appellee patently is in error in its charge that Miles "fails to illustrate one single expense paid after May 13, 1960". It stands undisputed that final settlement with the Mathis Heat Pump Company, attorneys' fees, and other expenses in connection with the J.E.H.-New Amsterdam litigation (the very recovery which is absolutely essential to entitle Locke's assignees to more than \$85,000.00 under the Agreements, by whatever interpretation), and the necessary costs and expenses of Miles' defending itself against the Gary H. Reid and Texas Plumbing claims, all of which arose out of, and were directly related to, actual construction, all occurred after May 13, 1960. Manifestly, Appellee is quibbling when

it charges that Miles computed net return, but yet “contended, even at trial, that it was incapable of calculating net return”. We, of course, did not make this sweeping claim.

Nevertheless, it is perfectly obvious that any recovery through litigation, settlement, or otherwise, which reduces costs, and thereby increases net return, that any necessary expense incurred, either in any such litigation or otherwise, and completing and finally closing the project, and any defeat of a contended for position which would increase costs, necessarily affects the computation of net return. Since the Texas Plumbing action had not, at the time of the trial, and as yet has not, reached finality, its resolution and the payment of costs and expenses incident to it necessarily will affect the precise amount of net return.

However, there necessarily comes a time when, as a practical matter, it is possible, through engaging in comparatively simple arithmetic computations, to determine that remaining contingent claims will not affect the result, one way or the other. This now applies to the Texas Plumbing claim, a matter directly related to the actual construction, the amount of which, with a fair estimate of litigation expense, will not affect the result under the October 8, 1956, Agreement, as amended, regardless of how it is finally determined.

But until the final resolution of the Gary Reid claim, it was not known, and it could not be known, how that final result, whether considered singly or in combination with the Texas Plumbing claim, would affect the final result under the October 8, 1956, Agreement, as amended.

Although Appellee accuses Miles of taking the position that attorneys’ fees, court costs, and expenses

incident to the very litigation in the case at bar were to be considered in determining net return, we state, unequivocally that this is not, and never has been, Miles' position. The litigation in the case at bar necessarily stands on an entirely different footing than that arising out of and related to actual construction under the Contract between Miles and its Subcontractors, or their sureties.

**Conclusion.**

For the reasons advanced in Appellant's Opening Brief and above, we feel that the Judgment of the District Court should be reversed.

Respectfully submitted,

FORSTER, GEMMILL & FARMER,

By ROBERT M. SWEET,

*Attorneys for Appellant.*



### **Certificate.**

I certify that, in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion the foregoing Brief is in full compliance with those rules.

ROBERT M. SWEET.









## APPENDIX.

Analysis of the Opinions in *Shields v. Rancho Buena Ventura*, 38 Cal. App. 696, 177 Pac. 499, and *Shields v. Rancho Buena Ventura*, 187 Cal. 569, 203 Pac. 114.

In the first Opinion, it is disclosed that the plaintiff was the owner of a little more than a quarter of the capital stock of the defendant; that the operation of the ranch had been unsuccessful, at least from a cash point of view; that the shareholders had been required to make advances to the corporation to keep the project going, apparently to the displeasure of the other shareholders; and that the contract in question was negotiated with the end in view of attempting to eliminate further cash contributions by the shareholders. The written agreement provided that the plaintiff was to keep a record of

“receipts and expenditures . . . and shall pay and discharge at his own account and expense all of the expenses of conducting, farming and managing said ranch and property, and everything done or to be done under or in accordance with the *terms of this lease*, . . . ; and the proceeds of said ranch shall be first applied upon and in or toward the satisfaction thereof, and after all of said charges and expenses are first paid, the [plaintiff] shall have and receive for his use and benefit and as full compensation for his services, fifteen hundred dollars for each year . . . , and all of the rest, residue and remainder of said proceeds of said ranch in excess of the expenses thereof as aforesaid shall be paid over . . . to the [defendant].” (Italics added.)

It was further provided that the household and living expenses of the plaintiff and his family should be considered a part of the expenses of running and maintaining the ranch, and should be charged to and paid for out of the proceeds thereof, but not otherwise.

While the second Opinion appears to characterize the arrangement between the parties as an employment agreement, this obviously was done for the sake of simplicity, and, in the posture of the case at that time, reached the same result as if the agreement had been characterized, as it truly was, and as the written agreement so states, as a lease. The plaintiff was, in fact, a tenant farmer entitled to his living expenses plus \$1,500.00 per year, if, in each year, the operation of the ranch produced this amount of money over and above the expenses of operation, with the out-of-pocket living expenses of the plaintiff and his family to be considered as a part of the expenses.

The first Opinion held that plaintiff had not produced sufficient evidence to show an excess of \$1,500.00 in each year of operation.

The second Opinion held that the plaintiff had adequately shown this, and, in addition, had shown himself to be entitled to *reimbursement* of some \$1,400.00, net, invested by him.



NO. 18643

IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

WALLACE LEROY SCHIERS,

Appellant,

v.

THE PEOPLE OF THE STATE  
OF CALIFORNIA, et al.,

Appellees.

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BRIEF OF APPELLEES

APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF CALIFORNIA

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IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

WALLACE LEROY SCHIERS,

Appellant,

v.

THE PEOPLE OF THE STATE  
OF CALIFORNIA, et al.,

Appellees.

BRIEF OF APPELLEES

Appeal from the United States  
District Court for the Southern  
District of California

JURISDICTIONAL STATEMENT

The United States District Court has jurisdiction to entertain a petition for a writ of habeas corpus by a state prisoner. 28 U.S.C.A. § 2241(a), (c)(3). Such a petition was filed on July 13, 1962. (Fed. Tr. p. 2.)<sup>1/</sup>

This court has jurisdiction to review on appeal a final order of a district judge denying a writ when a certificate of probable cause has been granted. 28 U.S.C.A.

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1

All references to the Clerk's Transcript on appeal in this Court will be designated as "Fed. Tr." The state record will be designated as "Rep. Tr." and "Cl. Tr."





§ 2253. On July 1, 1963 an order was entered denying a petition for the writ of habeas corpus, due to the failure to present a meritorious federal question. (Fed. Tr. pp. 255-256.) A notice of appeal was filed on July 2, 1963. (Fed. Tr. pp. 260-262.) A certificate of probable cause was entered on the same date. (Fed. Tr. p. 285.)

#### STATEMENT OF THE CASE

An information filed by the District Attorney of Los Angeles County on March 15, 1957 charged petitioner with the murder of his wife. (Cl. Tr. p. 1.) A jury found petitioner guilty of murder in the second degree. (Cl. Tr. pp. 6-14.) A motion for new trial was denied and petitioner was sentenced to the state prison for the term prescribed by law. (Cl. Tr. p. 16.)

The judgment was affirmed May 12, 1958 on appeal by the District Court of Appeal, 2d Appellate District, Division Three. (The opinion is reported in People v. Schiers, 160 Cal.App.2d 364, 324 P.2d 981.) A petition for hearing was denied by the State Supreme Court on July 11, 1958. Three of the seven justices were of the opinion the hearing should be granted. Schiers, p. 378. Subsequently, on October 19, 1960, petitioner made a motion in the District Court of Appeal to recall the remittitur.



No petition for certiorari with the United States Supreme Court has been filed. (Fed. Tr. p. 17.)

Petitioner does not claim that a petition for habeas corpus has been filed in the state courts.

#### STATEMENT OF FACTS

A summary of the state reporter's transcript is contained in the opinion of the State District Court of Appeal. See People v. Schiers, supra, 160 Cal.App.2d 364, 367-371, 324 P.2d 981.

#### SUMMARY OF APPELLANT'S CONTENTIONS

The arguments advanced by petitioner appear to fall in the following categories:

1. He was held in custody seven days before arraignment;
2. Counsel was ineffective;
3. There were secret trial proceedings, and hence a denial of public trial;
4. There was false testimony and suppression of evidence;
5. There was deliberate introduction of lie detector testimony;
6. The jury was erroneously instructed on accusatory statements;



7. Photographic evidence important in petitioner's defense was withheld from the jury.

After appellant filed the petition for habeas corpus in propria persona, counsel was appointed to assist him and an amendment to the petition was filed as well as a memorandum of points and authorities in opposition to the motion to dismiss. In part these support contentions made in the original petition and, in part, new points were added or developed. (Fed. Tr. p. 224, et seq.) These follow:

1. There was a failure to appoint counsel on appeal;

2. Petitioner was denied the right to appear at the oral argument;

3. He was denied the right to correct the record;

4. Petitioner was not notified of the affirmance of the judgment on time.

#### SUMMARY OF APPELLEES' ARGUMENTS

Appellees controvert the foregoing claims of error and contend that the petition for a writ of habeas corpus was properly dismissed.





## ARGUMENT

### I

#### THERE WAS NO PREJUDICE BASED ON AN ILLEGAL ARRAIGNMENT

The petition alleges that appellant was illegally detained for seven days before arraignment. (Fed. Tr. p. 19.)

This contention was not raised at the trial nor could it be reviewed by appeal.

People v. Pollart, 208 Cal.App.2d 793, 795; 25 Cal.

Rptr. 678;

People v. Finley, 174 Cal.App.2d 206, 211; 344 P.2d 614.

The reliance on the McNabb-Mallory rule -- see McNabb v. United States, 318 U.S. 332, 343, 63 S.Ct. 608, 87 L.Ed. 819; Mallory v. United States, 354 U.S. 449, 77 S.Ct. 1356, 1 L.Ed. 2d 1479 -- was modified subsequently by appointed counsel, conceding that the mere failure to comply with local statutes does not violate a federal constitutional right (Fed. Tr. p. 229), but contending that the lie detector evidence induced prejudice.

While California has been critical of officers who transgress Section 825 of the California Penal Code -- see People v. Grace, 166 Cal.App.2d 68, 78-79, 332 P.2d 811; -- California has not adopted the McNabb-Mallory rule



and adheres to the rule expressed in Rogers v. Superior Court, 46 Cal.2d 3, 10, 291 P.2d 929. Unless some prejudice can be shown such as the taking of admissions or confessions, California follows the rule that there is no unfair trial. People v. Van Eyk, 56 Cal.2d 471, 480, 15 Cal.Rptr. 150.

Appointed counsel suggested that the prosecution secured the lie detector evidence and pictures showing marks on petitioner's hands. We contend that the lie detector evidence was excluded by the court and the jury was admonished to disregard it. The District Court of Appeal held that it was error to relate this to the jury but not prejudicial. The fact that it may have been obtained during an illegal detention does not alter this conclusion. The photos of appellant's body and hands are not shown to have been taken during an illegal portion of the detention. (See Rep. Tr. p. 117.) The length of the detention would not make the pictures untrustworthy and since the benzidine tests were taken the first day and the evidence of blood is perishable, it is probable that the photographs were taken before a prolonged detention.

We note in passing that appellant in his petition regards the color slides as important to his defense and even complains of the purported failure to





put some of them in evidence. Moreover his testimony at the trial conceded what the color slides showed, as will be demonstrated.

We note too that all we have before us are petitioner's statements, and in places he speaks of having an attorney during this period. (Fed. Tr. pp. 20, 269-270.)

There has never been a hearing in the state courts to determine the truth of these allegations. Petitioner has the presently existing remedy of habeas corpus in the state court. Accordingly, this court should in comity decline to consider the matter.

## II

### PETITIONER WAS ABLY REPRESENTED BY COUNSEL AT THE TRIAL

Petitioner contends that Jerry Giesler and Rex Eagen, his lawyers at the trial, were incompetent for failing to raise the question of the illegal arraignment. (Fed. Tr. pp. 17-20.) The record does not disclose why they failed to raise the point. It may be that they had studied the claim and concluded, as we have, that it is meritless.

Petitioner also contends that his lawyer blacked out during the trial. Cf. People v. Davis, 48 Cal.2d 241,



252-258, 309 P.2d 1. Apparently the attorney struck his head diving into a swimming pool and claimed to suffer from the effects of the blow during the trial.

The point was fully considered on appeal and we adopt the opinion's conclusion and reasoning as our position.

See People v. Schiers, 160 Cal.App.2d 364, 376-378, 324 P.2d 981.

Appellant objects to the continuance given to counsel to recuperate (Fed. Tr. pp. 37-38), but this claim requires no comment.

Petitioner also complains of false representations by defense counsel as to the admission of certain photographic evidence. The claim is that the defense attorney told petitioner certain slides were admitted but they were not. We shall have occasion to discuss the slides at a later point and will present our reasons then to show that petitioner suffered no prejudice.

### III

#### APPELLANT WAS NOT PREJUDICED BY ANY SECRET TRIAL COURT PROCEEDINGS

Petitioner sets forth an extended attack at trial court proceedings purportedly held in his absence and in judicial chambers. (Fed. Tr. pp. 27-32.)



It appears that there were some proceedings to exonerate bail and there was some preliminary discussion not in the record. (Rep. Tr. A-1, in July 2, 1957 at 9:45 a.m.; Fed. Tr. p. 54.) Appellant wants these proceedings to have been held before the jury. (Fed. Tr. p. 23, lines 29-30.)

There were other proceedings to pass on the exhibits in the presence of petitioner and his counsel but not the jury. (Rep. Tr. p. 342.) There were also some preliminary discussion about the inadmissibility of the lie detector evidence before the jury was brought in and instructed. (Rep. Tr. p. 299.)

Passing on the exhibits and instructions before giving them to the jury is a well defined and sanctioned legal procedure, designed to protect a defendant from prejudice. We deem argument to be unnecessary. See People v. Gotham, 185 Cal.App.2d 47, 57, 8 Cal.Rptr. 20.

As to the exoneration of bail, this had nothing to do with the determination of guilt or innocence. The jury was not present. We may well say here what was said in People v. Ang, 204 Cal.App.2d 553, 556, 22 Cal.Rptr. 455:

" . . . The incident in question was no part of the defendant's trial nor of the criminal proceedings to which he was a party; involved merely an





administrative function of the trial judge; and did not come within either the letter or the spirit of the law which requires his presence. . . ."

Snyder v. Massachusetts, 291 U.S. 97, 106-108,  
54 S.Ct. 330, 98 L.Ed. 674, 90 A.L.R. 575.

This analysis effectively demonstrates that petitioner was not denied a public trial.

#### IV

#### THERE WAS NO WILLFUL SUPPRESSION OF EVIDENCE OR FALSE TESTIMONY

Petitioner makes allegations of willful suppression of evidence and knowing use of false testimony, yet it is evident from the argument that these are no more than conclusionary statements and that petitioner, who was represented by counsel, has no capability of substantiating such wild claims. He refers to purported conflicts between the testimony at the preliminary and at trial but these were before the District Court and do not uphold the claim. After appointing counsel, who worked diligently on petitioner's behalf, the District Court could have concluded that no hearing was necessary as nothing could have been adduced at it by petitioner that was not already in the record.



V

THERE WAS NO PREJUDICE IN THE  
LIE DETECTOR TEST DISCLOSURES

This matter has been fully considered in the District Court of Appeal's opinion, and we adopt the conclusions reached there as our own.

VI

PETITIONER WAS NOT PREJUDICED BY  
THE GIVING OF INSTRUCTIONS ON  
ACCUSATORY STATEMENTS

The point is summarized and decided by the State District Court of Appeal.

People v. Schiers, 160 Cal.App.2d 364, 378, 324  
P.2d 981.

We adopt the position taken by the District Court of Appeal in respect to the purported error not being prejudicial and submit that there was no federal constitutional deprivation.

VII

PETITIONER WAS NOT PREJUDICED  
BY THE PRESENCE OR ABSENCE OF  
THE COLOR SLIDES

Petitioner tells us how his attorney had related to him that certain prosecution photographs were not admitted; that Eagen was mistaken in thinking they were;





that the jury had asked to see them and that Eagen said they were then admitted in evidence. (Fed. Tr. p. 56.)

Appellant does not complain of the possibility they were shown to the jury but rather of the possibility they were not. He notes that the opinion of the District Court of Appeal said he had marks on his hands and photos were put in. (Fed. Tr. p. 62.)

Petitioner tells us his whole defense consisted of the photographs not admitted. (Fed. Tr. pp. 100, 112.) His story is that the police had said there were negative reactions below the knees to support a story of rape of the deceased after death. (Fed. Tr. p. 103.) Appellant insists the police testified falsely about positive reactions between the waist and knees. (Fed. Tr. p. 104.)

So far as we can see it makes little or no difference what the "blood--no blood" pattern was.

Petitioner is concerned with an allegation never brought against him. (See Fed. Tr. p. 267.) No one has formally charged him with having intercourse with his wife after decease and this suggestion has not been made in support of the murder charge. A "blood--no blood" pattern showing its absence or presence below the knees was unimportant. As the charge was not made or implied in the proceedings, the absence of refutation could not



have aided petitioner. The point remains that there is strong evidence he had a lot of blood on him. His own testimony buttresses the scientific evidence:

"Q BY MR. EAGAN: How many times did he touch your body with a swab?

A At that time he merely tested my hands. He smeared this stuff on with swabs and an immediate blue streaks came onto my hands and I asked, I asked him, I said, 'What does that indicate?'

And he looked at me, didn't say anything. And then he started smearing it around further on my hands and told me that he -- he asked a question. He says, 'Do you work in a slaughter house?'

I, of course, felt that the test then must indicate blood or he wouldn't have made that remark, and I asked him again and he said, 'Yes, certainly, it indicates blood.'

Q What did you say?

A I don't remember what I said. Certainly I was surprised, and Mr. Jones stated that I said, 'My God, this places me in a horrible position.' I don't think I said that, but I could have. I don't remember what I said.

Q Do you have any explanation at all, Mr. Schiers, for the reaction to the benzidine test?



A I do not.

Q Do you know if you have come in contact with any of the substances or do you have any recollection now if you had come in contact with any of the substances Mr. Pinker said would give the same reaction?

A I do not recall, no, sir.

Q Now, after the test you were taken by Sergeant Belle and Sergeant Ortiz to the Van Nuys Station, were you?

A Yes. After the test on my hands, Mr. Jones asked me if I would go into the kitchen and take off my clothes and he wanted to test further on my body for blood. He did. He made crossmarks up and down my arms and made, I think, three or four marks on the right and left sides of my chest. They showed me blood stains in the bathroom No. 2 in the commode and in the sink. He asked me if I could explain those. I told them no." (Rep. Tr. p. 476, line 1 - p. 477, line 11.)

It is apparent from this evidence that it was appellant's testimony he had a positive benzidine reaction on his hands and over much of his body. Whether or not there were color slides introduced to corroborate appellant's story is not important. In view of appellant's



The first part of the report is a general statement of the  
purpose and scope of the study. It is followed by a  
description of the methods used in the study. The third  
part of the report is a description of the results of the study.

The results of the study are presented in the fourth  
part of the report. The results are discussed in the fifth  
part of the report. The sixth part of the report is a  
conclusion.

The conclusion of the study is that the results of the study  
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testimony we deem the statement that his fingers were saturated with blood to be a fair inference from the record.

Petitioner also complains of a statement in the record that Mr. Schiers had his fingers saturated with blood. (Fed. Tr. pp. 63-64, 213.) He claims that this was really a reference to Mrs. Schiers. Complaint is also made of a statement purportedly made by Justice Shinn at the oral argument on the motion to recall the remittitur (Fed. Tr. p. 81), referring to the benzidine test as conclusive. Petitioner tells us he would have challenged this at the trial but that tests performed by the defense indicated that blood was "the only substance known to have been available" that could do this. (Fed. Tr. p. 92.) There was no attempt to refute the idea of conclusiveness because petitioner realized such an attempt would prove futile. (Fed. Tr. pp. 93-94; cf. Fed. Tr. p. 218.)

We see no merit whatever to petitioner's allegations. They do not present even a meritorious state question.

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## VIII

### THERE WAS NO ERROR IN PROCEDURE ON THE APPEAL

Appointed counsel raised several claimed defects on the appeal, which we will consider in turn.

#### A. Failure to Appoint Counsel

At the time petitioner's appeal was processed through the California courts when counsel was requested an independent investigation was made of the record and counsel was appointed if it would benefit the appellant or the court.

People v. Hyde, 51 Cal.2d 152, 154, 331 P.2d 42;

Cf. the concurring opinion of Traynor, J., in

People v. Brown, 55 Cal.2d 64, 69, 9 Cal.

Rptr. 836.

Subsequently in Douglas v. California, 372 U.S. 353, 83 S.Ct. 814, 9 L.Ed. 2d 811, the United States Supreme Court concluded that it was necessary to have appointed counsel for indigents on appeal in preference to the former system. No request for counsel on appeal was ever made and petitioner consulted with his trial lawyers about the appeal before he proceeded in propria persona.

If it is assumed that the Douglas case will be applied retroactively (cf. Hurst v. California, \_\_\_\_ F.2d





\_\_\_ (9th Cir. 1963), petitioner has a presently existing state remedy in that he can make a motion to recall the remittitur.

People v. Miller, 218 A.C.A. 654, 655, 32 Cal.

Rptr. 396

Such a motion was made by appellant but long before the Douglas case and on different grounds.

Moreover, we take the position that if appellant desired counsel on appeal he should have requested it. He should not proceed in propria persona, as he is doing in this court, and then claim later that the appellate court is in error. In the absence of a request, there has been no denial of appointed counsel and no constitutional deprivation.

B. Appearance at Oral Argument

Petitioner contends that he was denied the right to appear at the oral argument.

There is no indication of what material appellant desired to present to the court or why he could not have submitted it in writing. It has always been recognized that production of prisoners for post-trial procedures presents an administrative burden.

Sanders v. United States, 373 U.S. 1, 20, 83 S.Ct.

1068, 10 L.Ed. 2d 148.

The purpose of seeking ostensible relief can be the trip



to court. The security problems, particularly with convicted murderers, are apparent. Appellate courts are rarely equipped to handle such problems.

See Price v. Johnston, 334 U.S. 266, 68 S.Ct. 1049, 92 L.Ed. 1356, indicating that oral argument may be circumscribed on appeal for prisoners.

C. Correction of the Record

We have already analyzed this point in passing, and have concluded that appellant's requests for augmentation were as to matters that had no controlling significance.

D. Notification of Affirmance of Judgment

Petitioner claims he did not receive a copy of the opinion of the District Court of Appeal for some protracted period of time. The allegation rests solely on the strength of his own credibility. We would be reluctant to allow prisoners to create error by denying they had failed to receive legal documents from the court.

Moreover, petitioner filed a petition for hearing which was carefully reviewed, and the District Court of Appeal can be depended upon to supervise properly the work of its clerks, or even recall the remittitur if necessary.

See People v. Perry, 223 A.C.A. 503.



## CONCLUSION

Petitioner attacks the handling of the matter by the Federal District Judge but there is nothing to indicate that the judge did not consider all of the petition and its amendments, as well as the state transcripts.

We submit that the District Judge made the correct decision. He allowed a hearing, and petitioner argued the matter to whatever extent he pleased.

There was no request to make a factual presentation, nor would such a factual hearing be necessary if our position is sustained. To grant a factual hearing on every charge and complaint made in the petition would require a protracted proceeding, possibly months long. There was no necessity for it under these circumstances. A factual hearing could not have served a useful function.

It is submitted that petitioner has not presented a meritorious federal question and we respectfully request that the judgment be affirmed.

Respectfully submitted,

STANLEY MOSK, Attorney General

WILLIAM E. JAMES,

Assistant Attorney General

JACK E. WEBER,

Deputy Attorney General

Attorneys for Appellees





# CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

JACK K. WEBER

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No. 18644

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IN THE  
**United States**  
**Court of Appeals**  
For the Ninth Circuit

---

PORT OF PASCO,  
a municipal corporation,

vs.

PACIFIC INLAND NAVIGATION  
CO., INC.,

*Appellant,*

*Appellee.*

No. 18644

*On Appeal from the District Court of the United  
States, for the Eastern District of Washington,  
Northern Division*

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**BRIEF OF APPELLANT**

---

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**BRIEF OF APPELLANT**

---

**STATEMENT AS TO JURISDICTION**

This action concerns an explosion of a cargo of gasoline on appellee's Barge 535, Port of Longview, which occurred on December 16, 1958, while the barge was moored at one of appellant's docks on the Columbia River at Pasco, Washington.

The action was brought by appellee, Pacific Inland Navigation Company, seeking to avail itself of the provisions of Title 46 U. S. Code §181, et seq., "An Act to Limit the Liability of Ship Owners and for



Other Purposes,” and also seeking to enjoin the further prosecution of an action which appellant had previously commenced in the Washington State Superior Court for Franklin County to recover for the damage to its dock (Tr. 1-15). The specific statutory authority for this type of action rests in Title 46 U. S. Code §183-185.

Following the commencement of this action, an agreed order was entered by the District Court by the terms of which the State Court action was to proceed to trial for determination of the issues of liability and damages and, if the State Court found liability, the parties were to return to the District Court which was then to pass upon the question of limitation of liability (Tr. 37-39).

Thereafter, the State Court found that appellee was liable and assessed appellant's damages at \$55,464 (Tr. 47-53). This case was then tried by District Judge Charles L. Powell, and, after an oral ruling favorable to appellee, Findings of Fact, Conclusions of Law and Judgment limiting liability were entered on December 27, 1962 (Tr. 113-134).

Appellant filed Notice of Appeal on January 25, 1963, or well within the time permitted by Title 28 U. S. Code §2107 (Tr. 137). An appeal bond was filed by appellant at the same time (Tr. 135). Accordingly, this Court has jurisdiction of this appeal pursuant to Title 28 U. S. Code §1291 and §2107 and FRCP Rule 73.

Appellant's Designation of Contents of Record on

Appeal, pursuant to FRCP Rule 75, was filed with the district court clerk on January 28, 1963, appellant therein designating that the entire record should be included (Tr. 138). The time of docketing the record with this court was extended to April 22, 1963, by order of the District Judge entered February 15, 1963, and the record was docketed with this court on April 19, 1963 (Tr. 349).

### STATEMENT OF THE CASE

A single question<sup>1</sup> is presented by this appeal: Under 46 U. S. Code §183 (a), which provides for the limitation of the liability of a vessel owner where the casualty occurred “without the privity or knowledge of such owner”, was there any substantial basis for the ruling of the District Judge limiting liability, particularly in view of the admitted facts contained in the pre-trial order?

On December 16, 1958, one of appellee’s barges, known as Barge 535, Port of Longview, exploded, burned and sank while moored alongside a dock owned by appellant, Port of Pasco. Appellant’s dock sustained damage as a result of this casualty in the amount of \$55,464.00 (Tr. 67).

Barge 535 had arrived at appellant’s dock in Pasco from Linnton, Oregon, on December 15, 1958, carrying a cargo of 328,056 gallons of gasoline (Tr. 63, 67). Preparatory to the actual unloading of the cargo into

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<sup>1</sup>Appellant has abandoned the jurisdictional question raised by Point 1 of Appellant’s Statement of Points, filed pursuant to Rule 17 of this Court.

appellee's adjacent tank farm, two of appellee's subordinate employees at Pasco, Gale Oldfield and Wilbur Bunce, boarded the barge at about 9:00 p.m. to adjust the throttle linkage on a diesel motor which powered the pump on the barge (Tr. 174).

While Oldfield and Bunce were on the barge, they found that the circuit breaker switch controlling the starboard deck lights tripped off after the starboard lights had been turned on momentarily (Tr. 177, 188). It was a conceded fact that "Oldfield and Bunce did not possess sufficient skill or understanding of things electrical so as to realize that the circuit breaker switch, by so tripping, was giving notice or warning of a defective or shorted condition" in the starboard deck light circuit (Tr. 68). Mr. Oldfield, believing that the trouble was in the circuit breaker switch, replaced this unit, following which the lights appeared to function normally (Tr. 67-69). In fact, however, the circuit breaker had tripped because of a short circuit of an intermittent nature in the starboard deck light circuit itself (Tr. 67-69).

Thereafter, the unloading of the cargo of gasoline was commenced and proceeded for about four hours with the starboard deck lights on, until shortly after midnight on December 16, when a violent explosion occurred (Tr. 68, 205, 150). The explosion was set off by an electric arc produced by the same short in the starboard deck light circuit which had previously manifested itself to Oldfield and Bunce by the tripping of the circuit breaker, this electric arc having

ignited the gasoline vapors incident to the unloading operation (Tr. 67-68). The use of the deck lights, port and starboard, was a mere convenience, and in no wise necessary during the critical operation of loading or unloading of these barges, according to E. R. Boyles, appellee's supervisor of petroleum operations (Tr. 247).

Appellant, Port of Pasco, commenced an action against appellee in the Superior Court of the State of Washington, County of Franklin, seeking to recover for the damages to its dock. On January 26, 1962, at which time the aforesaid State Court action was about to be tried, appellee commenced this action by filing a "Petition for Exoneration from or Limitation of Liability" (Tr. 1-7).

Upon the filing of the initial petition in this action, appellee obtained an order restraining the further prosecution of the pending State Court action (Tr. 24-26). Thereafter, on February 15, 1962, based upon the stipulation of certain matters by appellant through its attorneys, and this being a single claim proceedings, the District Judge entered an agreed order modifying the aforesaid restraining order so as to permit the State Court action to proceed to trial "on the issues of the liability of the defendant (appellee), if any, and as to the amount of plaintiff's (appellant's) damages \* \* \*", but reserving to the District Court, jurisdiction "to determine and adjudicate the claim of petitioner herein and defendant in Cause No. 10527 of the State Court as to its right to



limitation of liability under the provisions of Title 46 U. S. Code §183, et seq., as amended" (Tr. 37-39). The aforesaid agreed order further provided "that upon final disposition of the issues as to liability and damages in cause 10527 by the State Court or upon disposition of any appeal from such State Court judgment, the issue as to petitioner's claim of limitation of liability shall be adjudicated by this court and the parties shall return to this court for that purpose" (Tr. 38-39).

The State Court action then proceeded to trial on April 3, 1962, before Judge James J. Lawless sitting without a jury, and ultimately resulted in findings of fact, conclusions of law and judgment awarding appellant, Port of Pasco, damages of \$55,464 against appellee (Tr. 47-53).

The State Court findings upon which its judgment in appellant's favor was based are of critical importance to this appeal. Certain of the findings were, by the terms of the pre-trial order herein, conceded to be binding upon appellee on the issues of liability and damages (Tr. 67). These concededly binding findings of the State Court, because of their importance to this appeal, are now set forth in full:

### "III.

"On the 16th day of December, 1958, the aforesaid Barge 535, Port of Longview, which was carrying a cargo of gasoline, was moored at one of plaintiff's docks at Pasco, Washington, and while the said cargo of gasoline was being discharged from the said barge into tanks situated



on the adjacent shore, an explosion occurred at the forward end of the barge, followed by fire which communicated to plaintiff's dock facilities, causing damage to plaintiff's said dock facilities in the amount of \$55,464.00.

#### "IV.

"The said explosion occurred from the ignition of gasoline vapors incident to the unloading operation, which said vapors were ignited by an electric arc produced by a short in the starboard deck light circuit of the said barge. The aforesaid short was a defective condition in the said starboard deck light circuit which had previously manifested itself to defendant's employees Oldfield and Bunce approximately four hours before the explosion by causing the circuit breaker switch which served the said starboard deck lights to kick off or trip, as the said circuit breaker switch was designed to do in the event of a malfunction in the circuit.

#### "V.

"The said circuit breaker switch is not a simple tool and the aforesaid employees of defendant, Oldfield and Bunce, did not possess sufficient skill or understanding of things electrical so as to realize that the circuit breaker switch, by so tripping, was giving notice or warning of a defective or shorted condition in the said starboard deck light circuit, and said employees proceeded to replace the said circuit breaker switch with a new one, which was followed by the apparently normal operation of the starboard deck lights. The said employees thereupon erroneously concluded that a malfunction in the circuit breaker switch itself had caused the circuit breaker to trip as aforesaid, but the Court finds as a fact that the circuit breaker switch was not in any

way defective but tripped as the result of a shorted condition in the starboard deck light circuit which was of an intermittent nature, and that defendant's said employees in nowise corrected this defective condition by replacing the said circuit breaker switch" (Tr. 67-69).

In addition to these concededly binding facts, the State Court entered its Finding VI, as follows:

"The defendant corporation, acting through its management personnel, had never issued any instructions to its employees at Pasco, Washington, nor otherwise eductated said employees as to proper and safe methods to employ in the event of any malfunction of the electrical systems on any of defendant's gasoline barges. The time of greatest hazard about a gasoline barge occurs when the gasoline is being unloaded and particularly when the tanks of the barge are nearly empty, and any malfunctioning of an electrical system which may produce a spark or arcing presents a situation of extreme peril of explosion. The management personnel of the defendant corporation were fully aware of the aforesaid hazard and of the function of circuit breaker switches as a warning device, but the said employees, Oldfield and Bunce, were not so aware. The defendant corporation, acting through its management personnel, was negligent in failing to issue instructions to its employees or to otherwise educate them as to the warning function of the circuit breaker switches and as to safe and proper practices when such circuit breakers trip, particularly when gasoline is being or is about to be unloaded. The said explosion would not have occurred if the said employees had been so instructed or educated, and the said explosion was proximately caused by the negligence of the defendant in this respect" (Tr. 51-52).

The allegation that appellee, Pacific Inland Naviga-

tion Company, "acting through its management personnel, was negligent in failing to issue instructions to its employees or to otherwise educate them as to the warning function of the circuit breaker switches and as to safe and proper practices when such circuit breakers tripped, particularly when gasoline was being or was about to be unloaded" was the only ground of negligence asserted upon the trial of the State Court action and was fully tried out there, appellee having been permitted to re-open and present additional testimony on that issue (Tr. 47, 49).

No appeal was taken by appellee from the State Court judgment and the parties thereupon returned to the District Court (Tr. 44-46).

After the formulation of a pre-trial order which embraced the foregoing conceded facts, the District Court action proceeded to trial (Tr. 62-88). Appellee offered testimony as to the custom of prudent barge operators under similar circumstances, and appellant offered rebutting testimony. Appellee's witnesses on this subject asserted that there was no custom among prudent operators to issue instructions to employees or to otherwise educate them as to the warning function of the circuit breakers on gasoline barges, whereas appellant's evidence on this subject was directly to the contrary (Tr. 303, 330-332).

Appellee also produced as a witness one Holt, an electrician from the city of Seattle, who testified to considerable experience with shipboard electrical installations. On direct examination Mr. Holt testified

that if the replacement of a tripped circuit breaker re-established the lights as was the case here, he would be "fairly positive" that it was the breaker that was at fault and not the line (Tr. 271). On cross-examination he conceded that even so, the tripping of the circuit breaker could have been caused by an intermittent short in the circuit (Tr. 283).

The evidence disclosed that the hazard of explosion was considerably greater when loading or unloading one of these gasoline barges, than when moored or under way in a loaded condition (Tr. 234, 246). *However, it was conclusively shown by appellee's own employees, including its supervisor of petroleum operations, E. R. Boyles, that appellee's management personnel had never issued any instructions to its employees or otherwise educated its employees as to what to do in the event of any apparent malfunction of the electrical systems or tripping of a circuit breaker on this barge or other barges in the company's system when loading or unloading was in progress or about to begin* (Tr. 185-186, 188-189, 210-212, 245-249). The use of the deck lights was not necessary, and appellee's own expert, Mr. Holt, testified that the safe procedure would have been to leave the lights off after the tripping of the circuit breaker (Tr. 246-249, 284-285).

At the conclusion of the trial in the court below, the District Judge, in a short oral opinion, announced that he was going to limit liability on the ground that there was a lack of privity or knowledge of the owners of the vessel, and said: "I am not passing on



negligence” (Tr. 344). It having been previously stipulated that the barge itself was without value following the explosion and ensuing fire, and that the freight bill associated with the cargo then being carried was in the amount of \$3,458.31, the District Judge entered a decree limiting liability to that amount and preventing the collection of the State Court judgment to the extent that it exceeded that amount (Tr. 132-134). *Appellee’s petition for exoneration from liability was denied by the District Judge* (Tr. 133). This appeal followed.

### SPECIFICATIONS OF ERROR

1. The District Court erred in making and entering its Findings of Fact in their entirety, for the reason that the matters conclusively determined by the Washington State Court, together with the admitted facts contained in the pre-trial order and other facts clearly established upon the trial, as a matter of law required contrary findings denying limitation of liability.
2. The District Court erred in making and entering its Findings of Fact in their entirety, for the reason that the granting of limitation of liability under the evidence here presented is a clearly erroneous result within the meaning of FRCP Rule 52(a).
3. The District Court erred in making and entering its Finding of Fact XXV (Tr. 128) as follows:  
 “That Petitioner had exercised due diligence



and had adequately performed any duty or obligation resting upon it as barge owner to instruct and educate its employees concerning the operations of handling and discharging bulk gasoline from its floating equipment, including BARGE 535, or to warn its employees concerning any known or probable hazards relating to the electrical equipment and circuit breakers installed on BARGE 535.”

for the reason that the evidence and admitted facts do not support this finding as a matter of law, or at least it is clearly erroneous within the meaning of FRCP Rule 52(a).

4. The District Court erred in making and entering its Finding of Fact XXVIII (Tr. 129) as follows:

“That Petitioner was not in privity with any act or failure to act of the tankermen and maintenancemen employed by it which the Court in Cause No. 10527 may have found to have been the proximate cause of the accident.”

for the reason that the evidence and admitted facts do not support this finding as a matter of law, or at least it is clearly erroneous within the meaning of FRCP Rule 52(a).

5. The District Court erred in making and entering its Finding of Fact XXIX (Tr. 129) as follows:

“That Petitioner was not negligent in failing to issue particular instructions or warnings to its maintenancemen and tankermen regarding proper procedures to follow in the event some difficulty or malfunction was encountered in the operation of electrical wiring circuits or circuit

breaker switches aboard BARGE 535 while engaged in transporting, loading or discharging bulk gasoline products.”

for the reason that the evidence and admitted facts do not support this finding as a matter of law, or at least it is clearly erroneous within the meaning of FRCP Rule 52(a).

6. The District Court erred in making and entering its Finding of Fact XXX (Tr. 129-130) as follows:

“That under all the circumstances, Petitioner exercised due diligence and reasonable care as to instructing its employees regarding operation, repair and maintenance of the electrical equipment, including circuit breakers, on BARGE 535 before and at the time of the accident on December 16, 1958, and was not negligent with respect thereto.”

for the reason that the evidence and admitted facts do not support this finding as a matter of law, or at least it is clearly erroneous within the meaning of FRCP Rule 52(a).

7. The District Court erred in making and entering its Conclusion of Law III (Tr. 131) as follows:

“That Petitioner has sustained the burden of proving that the explosion and fire involving BARGE 535 at the Port of Pasco on December 16, 1958, occurred without the privity or knowledge of Petitioner, its corporate officers, managing agents or supervisory personnel in the managerial hierarchy.”

for the reason that the evidence and admitted facts do not support this conclusion as a matter

of law, or at least it is clearly erroneous within the meaning of FRCP Rule 52(a).

8. The District Court erred in entering judgment limiting appellee's liability and in failing to enter judgment denying limitation of liability.

### SUMMARY OF ARGUMENT

All specifications of error pertain to our single contention on this appeal, that the evidence and admitted facts do not support the judgment of the District Court limiting liability. Therefore, all specifications will be discussed together.

**a. The District Court Ruling Limiting Liability was Erroneous as a Matter of Law.**

1. By agreed order, the District Court directed that the issue of liability was to be determined by the State Court and therefore, after the State Court's determination of this issue, appellee's responsibility for the explosion was permanently fixed.

2. The foreseeability of the explosion and its negligent causation by someone in appellee's organization were necessary ingredients of the liability found by the State Court.

3. The State Court, in findings which were conceded by appellee to be binding in these limitation proceedings, exonerated appellee's tankermen from negligence. Since appellee's

liability was not on a vicarious basis through the acts of its tankermen, but appellee was in any event liable for the explosion, as admittedly it was, its negligence necessarily resided at the management level of the corporation.

*States Steamship Co. v. U. S.*, (9th C.A.)  
259 Fed. (2d) 458.

4. If, as is the admitted fact, appellee's tankermen, Oldfield and Bunce, "did not possess sufficient skill or understanding of things electrical," appellee's management had a clear legal duty to fill this void through education, instruction or regulation of these subordinate employees.

Restatement of Agency, 2nd Ed., §213;  
57 C.J.S. 272, Master and Servant, §560.

5. It was the undisputed evidence in the District Court that appellee's management had not educated or issued any instructions to its tankermen as to safe practices to pursue in the event of any malfunction of the electrical systems on these barges, particularly when loading or unloading was underway or about to proceed.

6. The foregoing undisputed evidence of a failure to adequately instruct the subordinate employees, when coupled with the judgment of the State Court holding appellee liable but exonerating its subordinate employees from blame, establish the privity and knowledge of appellee corporation as a matter of law.

**b. The District Court Ruling, if not Erroneous as a Matter of Law, was Clearly Erroneous as a Matter of Fact.**



## ARGUMENT

- a. **The Admitted Facts in the Pre-Trial Order, Coupled With the Clear Showing of a Total Failure to Adequately Instruct the Subordinate Employees, Establish Privity and Knowledge as a Matter of Law.**

By the terms of the agreed order entered in this cause pursuant to which the action in the Washington State Court proceeded to trial, the issue of liability of Pacific Inland Navigation Company was to be determined by the State Court, and the U. S. District Court was, thereafter, to determine only the question of whether any such liability should be limited pursuant to 46 U.S.C. §183(a) (Tr. 37-39). The State Court, on the basis of evidence there presented, found common law liability (Tr. 49-53). By the findings of the State Court, this common law liability was based on negligence, and necessarily so, since this is not a situation where strict liability could be imposed (Tr. 51-52).

The issue of liability having been remanded to the State Court for determination, its finding thereon is binding in the present proceedings, and the District Judge recognized this when he said in his comments at the conclusion of the trial: "I am not passing on negligence" (Tr. 38, 344). He also recognized it by his subsequent action in entering judgment denying appellee's petition for exoneration from liability (Tr. 133). The single issue, then, before the District Court was as to whether or not appellee had sustained the



burden of proving its right to *limitation* of liability pursuant to 46 U.S.C. §183(a), which provides as follows:

“The liability of the owner of any vessel, whether American or foreign, for any embezzlement, loss or destruction by any person of any property, goods, or merchandise shipped or put on board of such vessel, or for any loss, damage, or injury by collision, or for any act, matter, or thing, loss, damage, or forfeiture, done, occasioned, or incurred, *without the privity or knowledge of such owner or owners*, shall not, except in the cases provided for in subsection (b) of this section, exceed the amount or value of the interest of such owner in such vessel, and her freight then pending.” (Emphasis supplied.)

This Court has had many occasions to consider the meaning of the foregoing statute. Your recent decision in *States Steamship Co. v. U. S.*, 259 Fed. (2d) 458, is, we feel, most instructive and closely parallels the legal situation in the present case, although the facts are quite different. Here the State Court found that this casualty was the result of negligence for which appellee was liable. Similarly, in *States Steamship Co.*, the District Judge found that there was negligence justifying and requiring the denial of the company’s petition for exoneration, but the District Judge granted the plea for limitation of liability. This Court, in reversing the latter action of the District Judge, said at page 473:

“It is thus apparent that the District Court found there was negligence. After noting that that finding was abundantly supported by evidence, we have by our decision pointed out that upon this record such negligence was necessarily

the negligence of Vallet. Accordingly, we hold limitation of liability must be denied.”

Elsewhere in the course of the opinion, this Court said at page 464 and 465:

“Finding VII (of the District Court) is as follows:

‘That the evidence is sufficient to show that the unseaworthy condition of the vessel at the inception of her voyage was without the privity or knowledge of petitioner, and the Court finds that the unseaworthy condition of the vessel at the inception of her voyage was not with the privity and knowledge of the petitioner.’

*“Before there could be a finding or conclusion such as Finding VII there would have to be a finding based on evidence that the negligence which the court found existed was that of a non-supervisory agent such as a master or an operating engineer. \* \* \**

“The reason there is no basis for the limitation here is that the only persons whose negligence could have operated to bring about the unseaworthy condition, the only persons to whom the lack of due diligence could possibly be charged, were persons who were managing officers of the corporation. The court not only did not find that the failure to exercise due diligence was that of minor or subordinate employees, but the court could not have made such a finding.” (Parenthesis and emphasis supplied.)

Similarly, in the case at bar there is a binding determination of liability based on negligence, and the only question in this proceeding is: *Whose negligence*, managerial employees or subordinate employees?

It is self-evident that, *as between master and servant*, a servant cannot be charged with responsibility,

or at least all responsibility, for injury or damage to the person or property of third persons where he acts or omits to act in ignorance of the hazards and consequences attendant upon his conduct. Knowledge that one's conduct involves an unreasonable and foreseeable risk of harm is an essential element to the imposition of liability based upon negligence.

A general statement of the basic principle involved is set forth in 38 Am. Jur. 665, Negligence §23, in the following terms:

"The foundation of liability for negligence is knowledge \* \* \* Concisely stated, negligence presupposes a duty of taking care, and this in turn presupposes knowledge or its equivalent."

The same principle was recognized and applied by this Court in the case of *United States v. Marshall*, 230 Fed. (2d) 183, 189, wherein it was stated:

"A defendant cannot be held responsible on the theory of negligence for an injury resulting from an act or omission on his part unless it can be shown that the defendant had knowledge or its equivalent—opportunity by the exercise of reasonable diligence to acquire knowledge—of the hazard to which plaintiff has been subjected."

Here it is conceded that Oldfield and Bunce did not have knowledge of the danger which inhered in their acts. The State Court found:

". . . The aforesaid employees of defendant (appellee), Oldfield and Bunce, did not possess sufficient skill or understanding of things electrical so as to realize that the circuit breaker switch by so tripping, was giving notice or warning of a defective or shorted condition in the said starboard deck light circuit, and the said

employees proceeded to replace the breaker switch with a new one, which was followed by the apparently normal operation of the star-board deck lights.”

In the pre-trial order, this finding was among those of the State Court which were conceded by appellee to be binding in these limitation proceedings (Tr. 67-68). On the basis of this finding, knowledge of the risk involved in replacing the tripped circuit breaker and re-energizing the circuit on appellee’s barge—an essential element in establishing negligence on the part of Oldfield and Bunce for the ensuing explosion—was *conclusively* and *admittedly* found to be lacking. Absent this element of knowledge, Oldfield and Bunce were not and could not be negligent and, as in the *States Steamship Company* case, the negligence that proximately caused the explosion was necessarily that of appellee’s managerial employees, in this instance, in totally failing to instruct or otherwise educate its rank and file employees as to safe procedures to be followed in dealing with electrical malfunctions during the unloading procedure.

An employer is at liberty to hire employees of any level of intelligence or training that he desires. However if, as in the present case, the employer chooses to hire persons with insufficient training or skill for the job at hand or some aspect thereof, a positive duty then devolves upon the employer to fill this void by such rules, regulations, instructions, education or supervision as the circumstances may require. That such a duty exists, and that it exists for



the benefit of third persons is, under the authorities, clear, and is more fully discussed hereafter at pages 30-34.

This action, from its inception, and in both the State and District Courts, was for damages that resulted from appellee's negligent failure to perform this duty. Respectfully directing this Court's attention to the evidence on this issue, it is undisputed that appellee's managerial personnel gave no attention whatsoever to the matter of precautions to be taken by its subordinate employees in the wake of electrical malfunctions while defueling its gasoline tankers of their highly explosive and dangerous cargoes. (Tr. 185, 186, 210-12, 245). Appellee's indifference to this critical phase of its operations was necessarily neglect on the part of its managerial employees, since it is obvious that rule-making and employee education are functions peculiar to and dischargeable only by management, for a breach of which management alone is responsible.

Appellee offered testimony of a claimed custom among barge operators to rely on their tankermen to deal instinctively with electrical malfunctions. This testimony, which was squarely met and flatly contradicted by appellant, was apparently offered for the purpose of excusing and justifying appellee's failure to perform this educational duty. We suggest to the Court that there was nothing magic about this evidence of a claimed custom, and it could not and did not change the substandard and negligent character of appellee's conduct in haphazardly dealing with so ex-



plosive and hazardous a mixture as gasoline vapor and air. Courts have universally condemned such attempts by an industry to thus justify its self-imposed standards, a point that will also be more fully discussed at pages 28-29. Be that as it may, however, we submit that such evidence of custom was entitled to no consideration, as it could only represent an attempt by appellee to contradict the admitted and established fact of liability, as conclusively found by the State Court.

Appellee also offered testimony in the District Court tending to show that the explosion was not foreseeable, and that there was no reason for management to anticipate and guard against its employees re-energizing an electric circuit after the current therein had been interrupted by the tripping of a circuit breaker. The manner in which the explosion of appellee's barge was triggered, as found by the State Court, was not unique. The reports contain a number of cases in which courts have been called upon to consider the question of liability for disasters caused by employees re-energizing an electric circuit after the current therein had been interrupted automatically through the operation of a safety device, such as a circuit breaker.

*Craft v. Pocahontas Corp.*, (W. Va.) 190 S.E. 687;

*Martin v. Northern States Power Co.*, (Minn.) 72 N.W. (2d) 867;

*Edgarton v. H. P. Welch Co.*, (Mass.) 74 N. E. (2d) 674, 679;

*Short v. Central La. Electric Co.*, (La.) 36 So. (2d) 658;

*Hughes v. La. Light & Power Co.*, (La.) 94 So. (2d) 532.

However, aside from considerations of the frequency with which mishaps have been similarly caused, a circumstance which bears directly on the issue of foreseeability, that issue was necessarily determined by the State Court when it resolved the issue of liability against appellee and found that the explosion was negligently caused.

It is fundamental that foreseeability by someone in appellee's organization of the chain of events that caused the explosion of its barge was essential before liability for negligence could be imposed upon it. Liability presupposes the existence of negligence and proximate cause, and these elements of liability in turn presuppose the existence of foreseeability. The rule in this respect was recognized by this court in the case of *Alaska Freight Lines v. Harry*, 220 Fed. (2d) 272, 275, wherein you quoted with approval from 155 ALR 157 as follows:

“Generally an act or omission does not constitute actionable negligence unless a reasonably prudent person placed in the position of the actor would have foreseen the probability of harm resulting from his acts or omissions.”

In other words, the whole includes the sum of its parts, and the binding determination by the State Court that appellee was negligent, necessarily included within it the equally binding determination

against appellee of all the elements of actionable negligence, including foreseeability.

Thus, it is appellant's initial position in this Court that the State Court determination of the issue of liability against appellee, coupled with the admitted facts by which appellee is bound and the clear showing on the trial below that no instructions of any kind were given to the subordinate employees as to safe methods of dealing with electrical malfunctioning, conclusively established a failure of appellee to discharge an affirmative duty peculiar to its managerial personnel, the foreseeable result of which was the explosion, and, therefore, appellee is not, as a matter of law, entitled to limit its liability.

**b. The District Court Finding that Liability Should be Limited is Clearly Erroneous as a Matter of Fact.**

We again refer to the decision of this Court in *States Steamship Co. v. U. S.*, 259 Fed. (2d) 458. At page 474, this Court discussed and recognized "the vast difference" between dockside casualties and disasters on the high seas, and quoted as follows from Gilmore and Black, *The Law of Admiralty*:

"The principle of the Limitation Act is the same as that found in the Harter Act and the Carriage of Goods by Sea Act: because of the extraordinary hazards of seaborne commerce and because the owner can exercise only a nominal control over his 'servants' once the ship has broken ground for the voyage, the owner should be entitled to exoneration from liability, or at least to a limitation of liability, for whatever happens after the ship has passed beyond his

effective control. *Contrariwise, he should be held to liability for all loss resulting from his failure to exercise effective control when he had the chance'*" (Emphasis by this Court.)

Earlier, at page 466, in the *States Steamship Co.* case, this Court also said:

"Within the meaning of the section of the statute limiting liability, 'knowledge means not only personal cognizance but also the means of knowledge—of which the owner or his superintendent is bound to avail himself—of contemplated loss or condition likely to produce or contribute to loss, unless appropriate means are adopted to prevent it.' *The Cleveco*, 6 Cir., 154 F. 2d 605, 613. The burden is upon the owner seeking limitation of liability 'to prove lack of knowledge or of the means of knowledge on his part or that of his marine superintendent that his vessel was unseaworthy.' *Id.* 'The measure in such cases is not what the owner knows, but what he is charged with finding out.' *Great Atlantic and Pacific Tea Co. v. Brasileiro*, 2 Cir., 159 F. 2d 661, 665."

Here, appellee's supervisor of terminals, E. R. Boyles, testified that he had no knowledge of the hazard of re-energizing an electrical circuit after the tripping of a breaker. The District Judge, seemingly on the basis of this, announced his finding that this occurrence was "without the privity or knowledge" of appellee. Thereafter, the District Judge made a formal finding of fact that appellee "had no knowledge of any unusual hazards" involved in re-energizing of the circuit (Tr. 105). However, no finding of fact was made as to an absence of circumstances which would charge appellee with such knowledge.



We assert that the danger of re-energizing an electrical circuit on a gasoline barge which is being or is about to be unloaded, where a fuse has blown or a circuit breaker has tripped, should be self-evident to persons at the management level of such a company. This is not a residential circuit where fuses blow because of the addition of too many appliances to the circuit. This is a circuit with a constant load of five lights, as shown by Exhibit 6, and when a circuit breaker trips on such a circuit, it is a clear warning that there may be a short somewhere in the line (Tr. 177).

Despite the denial of actual knowledge of this hazard, appellee's management personnel certainly had the means of knowledge. In conducting such a highly hazardous activity, they certainly were obliged to give some consideration to the perils incident to malfunctioning of the electrical systems on these barges, and similarly, they should have considered whether or not their employees knew how to safely cope with malfunctions, and to instruct or educate those who did not have such knowledge.

Here the involved employees, Oldfield and Bunce, did not have such knowledge. They did not have "sufficient skill or understanding of things electrical." To this finding the District Court was bound. Moreover, it is self-evident that appellee's employees were oblivious to the hazards involved in re-energizing the starboard deck lights on the barge during the unloading procedure, since their conduct in so doing



involved a grave risk of harm to their personal safety and well-being.

By cross-examination of appellee's witnesses, E. R. Boyles and R. E. Williamson, appellant established beyond question that appellee's management had never issued any instructions to its tankermen and other subordinate personnel as to safe methods to employ in dealing with electrical malfunctions, and simply left it up to Mr. Oldfield, as the maintenance man, to "fix what he could" (Tr. 185-186, 210-212, 245).

We cannot stress too strongly the undisputed fact, as conceded by appellee's supervisor, Mr. Boyles, that these deck lights were no more than a convenience, and not at all necessary for the unloading of the barge (Tr. 247). Mr. Holt, the electrician who testified as an expert witness for appellee, agreed that under such circumstances the safe thing to do was to leave the lights off, even though the trouble appeared to be in the circuit breaker itself (Tr. 285).

During Mr. Holt's direct examination, we find a curious bit of testimony along the same lines. He had testified that he would be "fairly positive" that the trouble was in the circuit breaker and not the line if, after the circuit breaker tripped, its replacement resulted in lights (Tr. 271). He was then asked, "Suppose that the lights did not go on or that it kicked off again after you had replaced the circuit breaker unit, what would you consider in your experience in this marine work should be done then?"

To this Holt replied, "I would leave it alone *until the unloading process was complete*" (Tr. 271). Elsewhere, Mr. Holt freely conceded his knowledge that a short circuit can be of an intermittent nature, as the State Court found this one to be (Tr. 280, 69). Thus Mr. Holt clearly recognized that, if a replacement circuit breaker again tripped when the line was re-energized, a short in the line was indicated and that it presented a danger during unloading. But, additionally, he recognized that shorts can be of an intermittent nature, so that whether or not the tripping continues after the replacement of the circuit breaker becomes of little significance in terms of danger.

In general, Mr. Holt and appellee's other witnesses testified that what Oldfield and Bunce did in this particular instance conformed to the standards and practices of the industry, and the holding of the District Judge limiting liability seemed to be on the basis of such testimony. We earnestly submit, however, that the foregoing testimony of appellee's own expert, clearly demonstrates how haphazard and lacking in attention to safety is any such practice in an industry concerned with the transportation of such a dangerous commodity.

The custom or practices of an industry are never controlling on the question of negligence. In *Texas & P. R. Co. v. Behmeyer*, 189 U. S. 468, 47 L. ed. 905, Justice Holmes said:

"What usually is done may be evidence of what ought to be done, but what ought to be done

is fixed by a standard of reasonable prudence, whether it is usually complied with or not."

In *The T. J. Hooper*, (2nd C.A.) 60 Fed. (2d) 737. we find Judge Learned Hand saying:

"There are, no doubt, cases where courts seem to make the general practice of the calling the standard of proper diligence; we have indeed given some currency to the notion ourselves (citing cases). Indeed in most cases reasonable prudence is in fact common prudence; but strictly it is never its measure; a whole calling may have unduly lagged in the adoption of new and available devices. It never may set its own tests, however persuasive be its usages. Courts must in the end say what is required; there are precautions so imperative that even their universal disregard will not excuse their omission."

The tanker industry of which appellee is a member is no exception to the general rule. In *Petition of Oskar Tiedemann & Co.*, (D.C. Del.) 179 Fed. Supp. 227, (affirmed in 289 Fed. (2d) 237) a gasoline tanker owned by the government was permitted, in accordance with a custom in the tanker industry, to sail with gasoline vapor in her tanks, the presence of which caused a violent explosion when it collided with another vessel. In denying the government's petition for exoneration from or limitation of liability for the explosion, the Court at page 238 observed the following with reference to the custom relied upon;

"The tanker industry cannot hoist itself by its own bootstraps through the device of setting up standards of conduct amounting to something less than reasonable care under all the circumstances and then predicate a defense on such substandards. The Federal and State Courts

have long since laid to rest the ghost of this argument.”

The Coast Guard regulations (46 C.F.R. 111.55.25) wisely require circuit breakers or fuses as overcurrent protection on vessels to “minimize the hazard of fire”. However, such devices are of little value if their functions and purposes are not understood. Appellee’s management certainly knew, and at least were charged with knowledge, that the handling, loading and unloading of gasoline and any malfunctioning of electrical systems and circuits do not mix. Certainly they had some duty to inquire into the hazards and the capabilities of the subordinate employees to safely cope with such hazards. And surely appellee’s management had the duty of instructing or educating employees who did not understand these things, as Oldfield and Bunce concededly did not.

The master’s duty in this respect is set out in Restatement of Agency, 2nd Ed., Sec. 213:

“A person conducting an activity through servants or other agents is subject to liability from harm resulting from his conduct if he is negligent or reckless:

- (a) in giving improper or ambiguous orders or in failing to make proper regulations; or
- (b) in the employment of improper persons or instrumentalities in work involving risk of harm to others; or
- (c) in the supervision of the activity; \* \* \*

“*Comment g. Inadequate regulations.* A master is negligent if he fails to use care to provide such regulations as are reasonably necessary to pre-



vent undue risk of harm to third persons or to other servants from the conduct of those working under him. See § 508 and the Restatement of Torts, § 317. One who engages in an enterprise is under a duty to anticipate and to guard against the human traits of his employees which unless regulated are likely to harm others. He is likewise required to make such reasonable regulations as the size or complexity of his business may require."

To this same effect, in 57 C.J.S. 272, Master and Servant §560, the rule is expressed in the following terms:

"Negligence of the master in failing properly to instruct his servants as to the method of performance of the work which they are employed to do renders him liable for injuries as to third persons resulting therefrom, as does his failure to see that his instructions are obeyed."

The master's duty to third persons in this particular was recognized in the early case of *Mitchell v. Boston & M. R.R.*, (N.H.) 34 Atl. 674. The facts, similar in principle to those before the Court in this case, showed that plaintiff was struck and injured by one of the defendant's trains while crossing a frequently used pathway in the defendant's yard. The defendant's engineer denied any personal knowledge of the pathway or the frequency of its use. The Court held that, assuming the engineer was free from fault with respect to the plaintiff's injuries because of his personal ignorance, his employer was in any event liable and stated:

"If he (the engineer) neither knew, nor reasonably could have known, the situation, and was



therefore personally without fault, the negligence was more immediately and directly that of the defendants, in not informing him of the pathway and of its use. *A master is as responsible for injuries caused by his negligence in not informing his servant of danger known to him, and not known by the servant, as he is for injuries caused by the personal negligence of the servant. He is not less responsible for his own negligence than he is for that of his servants.*" (Parenthesis and emphasis supplied.)

In *Dimmey v. West Virginia Traction & Electric Co.*, (W. Va.) 99 S.E. 93, a damage action for personal injuries sustained by the plaintiff when she was struck by one of the defendant's trolley cars, the Court recognized the rule that:

"The law imposes upon pedestrians and others using public highways in which railways are operated the duty of constant and vigilant care and prudence for their own safety. *At the same time, it imposes upon the railway company a duty, \* \* \* to adopt such rules, regulations, and methods of operation, as are reasonably necessary to prevent injury to them.*" (Emphasis supplied.)

Other cases either recognizing or applying the rule of liability for injury or damage to third persons resulting from a master's neglect to instruct or educate his employees as to the duties involved in their positions are:

*Sloss-Sheffield Steel & Iron Co. v. Bibb*,  
(Ala.) 51 So. 345;

*Penas v. Chicago, M. & St. Paul Ry. Co.*,  
(Minn.) 127 N. W. 926;

*Smith v. Boston & M. R. R. Co.*, (N.H.) 177  
Atl. 729.

This court, sitting in judgment of appeals in admiralty, has recognized a vessel owner's obligation to educate his employees concerning duties incident to their employment or hazards likely to be encountered in the performance of their duties, and on at least two occasions has denied limitation of liability for losses resulting from a negligent failure to perform this duty.

In *The Silver Palm*, (9th C.A.) 94 Fed. (2d) 776, a vessel owner's petition for limitation of liability for losses resulting from a collision was denied. It appeared that the collision was caused in part by excessive speed on the part of the captain of the vessel to which this Court held the owner had no knowledge and was not privy. However, it further appeared that the involved vessel had a peculiarity about its engine which made it unusually difficult and slow to execute a reversing maneuver and that this condition was a contributing cause to the collision. The owner of the vessel had knowledge of this peculiarity but had failed to bring it to the attention of the ship captain, and limitation of liability was denied because of the owner's—

“\* \* \* failure to communicate to the captain the peculiarity of the ship's extraordinary long stopping period from the usual speed at sea under emergency conditions requiring the reversal \* \* \*”

Similar in principle to the decision of *The Silver Palm* is the case of *In Re Pacific Mails S. S. Co.*, (9th C.A.) 130 Fed. 76, in which this Court denied a vessel owner's petition for limitation of liability

where it appeared that the loss of lives and property for which recovery was sought resulted from an inability on the part of the ship's officers to communicate orders for the lowering of lifeboats to its non-English speaking Chinese crew because of the language barrier. It was held that the owner of the vessel was negligent in failing to see to the education of the Chinese crew in emergency procedures.

There is nothing disclosed by this record which afforded any basis for appellee's management to assume that its subordinate employees in general or Oldfield and Bunce in particular had the know-how to safely handle electrical malfunctions on these gasoline barges. Notwithstanding this, appellee did so assume and gave no heed to their education or regulation, and in this, we say, appellee was personally negligent. Such negligence was a proximate cause of the explosion in view of the binding finding of the State Court that Oldfield and Bunce "did not possess sufficient skill or understanding of things electrical, etc." and the clear evidence that these men would have followed any instructions given them (Tr. 188-189). Had appellee's supervisory personnel but told the subordinate employees to proceed without lights under such circumstances, this disaster would have been avoided. The record clearly discloses this (Tr. 188-189).

We earnestly submit that the explosion was caused, at least in some part, by negligence personal to appellee and within its privity and knowledge and that

the finding of the District Judge to the contrary is untenable and clearly erroneous.

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This is not a case in which it was necessary for the District Court to weigh the relative merits of conflicting evidence nor would it be necessary for this court to do so in order to reverse the judgment below. Rather, the decision of the District Judge was, in our humble opinion, the result of a clearly erroneous factual conclusion from the admitted and undisputed facts. In other words, the District Judge, from a set of facts as to which there was not and could not be any dispute, held that the management personnel of appellee corporation was not negligent. We think this factual conclusion is untenable and that this Court should conclude, from these same undisputed and undisputable facts, that the involved casualty was, in fact, caused by negligence of appellee's management personnel or, in the words of the statute, that the casualty occurred with "the privity or knowledge" of the owners of the vessel.

Contrary to what occurred in the State Court trial, appellant, in the District Court trial of the limitation of liability proceedings, offered the testimony of only one witness, a Mr. John M. Knisley, a certified marine chemist from Seattle. His testimony was basically limited to the custom among ship owners with regard to instructing their employees as to safe practices in the face of malfunctions of the electrical system of gasoline barges, Mr. Knisley's version being that prudent barge owners instructed their employees



to totally refrain from re-energizing an electrical circuit which had given evidence of trouble where loading or unloading of gasoline was either in progress or about to begin (Tr. 330-332).

Appellant offered this testimony simply because appellee had previously offered the testimony of Walter T. House, a tug boat captain from Seattle, to the effect that operators of gasoline barges do not issue any specific instructions in such matters, rather relying upon their subordinate employees or tankermen to deal instinctively with any such electrical trouble (Tr. 303).

We suggest to this Court that the testimony of appellant's only witness, Mr. Knisley, be totally disregarded in the court's consideration of this appeal. It is our position that the established and admitted facts compel the factual conclusion that the owners of this barge were negligent in failing to issue any instructions to the subordinate employees or tankermen as to safe practices to employ in the face of electrical troubles, irrespective of what the custom may have been in the shipping or barging industry.

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Had there been no evidence whatsoever of the manner in which the explosion of appellee's barge occurred, this casualty would have presented a classic "*res ipsa loquitur*" situation, as the decisions of this Court make clear.

*Union Pac. R. Co. v. DeVaney*, (9th C.A.)  
162 Fed. (2d) 24;



*The Rocona v. G. F. Atkinson Co.*, (9th C.A.) 173 Fed. (2d) 661;

*Furness, Withy & Co. v. Carter*, (9th C.A.) 281 Fed. (2d) 264.

The doctrine of *res ipsa loquitur* is fully applicable to suits in admiralty.

*Austerberry v. U. S.*, (6th C.A.) 169 Fed. (2d) 583;

*Johnson v. U. S.*, 333 U. S. 46, 92 L. ed. 468.

In the nature of things, barges such as this do not explode in the absence of negligence of the operator, and the following are but a few of the many cases holding that a presumption or inference of negligence can be indulged under similar circumstances.

*Leathem, Smith-Putman Nav. Co. v. Osby*, (7th C.A.) 79 Fed. (2d) 280;

*Austerberry v. U. S.*, (6th C.A.) 169 Fed. (2d) 583;

*Gilroy v. Standard Oil Co.*, (N. J.) 151 Atl. 598;

*Guilford v. Foster & Davis*, (Okla.) 268 Pac. 299;

*Pope v. Edward M. Rude Carrier Corp.*, (W. Va.) 75 S. E. (2d) 584;

*Siniarski v. Hudson*, (Ill.) 87 N. E. (2d) 137.

Thus, without any facts beyond the mere explosion, there is a reasonable inference that someone connected with appellee, as the operating company, was guilty of negligence, either management or the employees immediately handling the barge.

Here, however, by way of the conceded or undis-

puted facts, we know considerably more about this explosion, all pointing inexorably to negligent causation by some person or persons in appellee's organization. We know as an absolute fact that it was caused by a short in the starboard deck light circuit which produced an electric arc igniting the gasoline vapors incident to the unloading operation which was in progress (Tr. 67-68). We know that this same short was a defective condition in the starboard deck light circuit which had manifested itself approximately four hours earlier to Messrs. Oldfield and Bunce, the two employees of appellee who were readying the barge for unloading (Tr. 68). At that time we know that the circuit breaker switch on the vessel which served the starboard lights had kicked off or tripped, as this device was designed to do in the event of a malfunction of the circuit—a clear advance warning (Tr. 68). We know that this short was of an intermittent nature and that such an intermittent short circuit can be anticipated (Tr. 69, 280).

Finally, as determinative of the vital question of where in appellee's organization resided the fault or responsibility for this disaster, we know that Messrs. Oldfield and Bunce "did not possess sufficient skill or understanding of things electrical" so as to realize that the tripping of the circuit breaker was giving notice of a short in the circuit, and proceeded to re-energize the circuit after replacing the circuit breaker switch, thereby, unbeknownst to them, and without negligence of their part, setting the stage for the explosion to follow (Tr. 68).

If our understanding of pre-trial procedures is correct, the foregoing facts found by the State Court and conceded to be binding in the pre-trial order, are not subject to being nibbled at or their potency lessened in any way by any testimony which may, thereafter, have crept into the record. Appellant, as we understand it, was entitled to rest its case on these facts with full confidence in their integrity. But, despite our efforts on the trial below to confine matters to the boundaries established by the pre-trial order, much testimony slipped in through appellee's witnesses as to such pre-determined matters. Because of this, we earnestly feel that the decision of the District Judge was subconsciously influenced by what amounted to a one-sided presentation of the issues already determined in the State Court, and that appellant was unwittingly placed at a fatal disadvantage by its total reliance on the pre-trial order.

Be that as it may, however, we feel that this Court, on taking this case by its four corners, should be left with a firm conviction that appellee is not entitled to limitation of liability.

### CONCLUSION

We earnestly contend that the judgment of the District Court should be reversed with directions to enter judgment denying appellee's "Petition for Exoneration from or Limitation of Liability" in its entirety. And we again direct the Court's attention to its final rehearing decision in *States Steamship*

*Co. vs. U. S.*, 259 Fed. (2d) 458, which, we feel, cannot be distinguished in principle.

Respectfully submitted,

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*Proctors for Appellant*

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# CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JEROME WILLIAMS

*Proctor*

## APPENDIX

## Table of Exhibits

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2	Copy of Answer	85	152-3
3-A	Copy Findings of Fact	85	152-3
3-B	Copy of Judgment	85	152-3
4	USCG Inspection Cert.	85	152-3
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14	Letter Memo 7/2/58	86	152-3
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No. 18644

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IN THE  
**United States Court of Appeals**  
**For the Ninth Circuit**

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PORT OF PASCO, a municipal corporation,  
*Appellant,*

v.

PACIFIC INLAND NAVIGATION CO., INC.,  
*Appellee.*

---

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR  
THE EASTERN DISTRICT OF WASHINGTON,  
NORTHERN DIVISION

---

**BRIEF OF APPELLEE**

---

CHARLES B. HOWARD  
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**FILED**

JUL 10 1962



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IN THE  
**United States Court of Appeals**  
**For the Ninth Circuit**

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PORT OF PASCO, a municipal corporation,	}	
	<i>Appellant,</i>	
v.	}	
PACIFIC INLAND NAVIGATION CO., INC.,		No. 18644
	<i>Appellee.</i>	

---

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR  
THE EASTERN DISTRICT OF WASHINGTON,  
NORTHERN DIVISION

---

**BRIEF OF APPELLEE**

---

**I.**

**STATEMENT AS TO JURISDICTION**

Supplementing appellant's Statement as to Jurisdiction, appellee refers this Court to Stipulation on behalf of the appellant as presented in the U. S. District Court (Tr. 29) shortly after Petition for Exoneration from or Limitation of Liability was filed in this cause (Tr. 1). The offer of this Stipulation by appellant (claimant below) was in accordance with the procedure approved by the Federal Courts to enable a State Court to proceed with initial determination of issues as to liability and damages in a single claim limitation of liability case.

*Petition of Republic of (South) Korea*, (D. Ore., 1959) 175 F. Supp. 732, 735, 736;

*Petition of Red Star Barge Line*, (CA 2, 1947) 160 F.(2d) 436, 438;

*Great Lakes Dredge v. Lynch*, (CA 6, 1949) 173 F.(2d) 281, 284.

By this Stipulation, appellant, among other things, expressly conceded appellee's (petitioner below) right to have all issues pertaining to its affirmative defense of limitation of liability in the State Court action determined by the U. S. District Court as a matter within the exclusive admiralty jurisdiction of the Federal Court (Stipulation, Sec. 5, Tr. 31). Appellant also expressly agreed that it would not raise any question as to the jurisdiction of the U. S. District Court to thereafter proceed with an ultimate determination of the issue of limitation of liability after the State Court had adjudicated questions as to liability and damages (Stipulation, Sec. 7, Tr. 32).

While appellant's Statement of Points on this appeal claimed that the District Court was without jurisdiction to entertain the Petition for Limitation of Liability, it will be noted that appellant expressly abandons this jurisdictional question by footnote 1, appearing at page 3 of its brief.

The admiralty and maritime jurisdiction of the Federal Courts has been extended to include damages to property on land (appellant's dock) by a vessel on navigable waters (appellee's BARGE 535) by 1948 amendment, Title 46, U. S. Code § 740.

## II.

### STATEMENT OF THE CASE

In addition to the statement of background facts by appellant (Br. 3-11), the appellee invites the attention of this Court to the following additional facts:

BARGE 535 had undergone annual inspection by the U. S. Coast Guard, which was completed on December 3,

1958, only thirteen days before the explosion and accident involved in this proceeding (Tr. 71, 230, and Finding of Fact XIV, Tr. 124).

Appellee's employees Oldfield and Bunce were the maintenanceman and tankerman respectively engaged in operations preparatory to discharge of the bulk gasoline cargo from BARGE 535 several hours before the accident occurred (Tr. 71, 174). Both of these men had been issued certificates by the U. S. Coast Guard, qualifying them to serve as tankermen to handle gasoline products of the grade to be discharged from BARGE 535 (Tr. 71 and Finding of Fact XV, Tr. 124). Both maintenanceman Oldfield and tankerman Bunce were competent and experienced as to the duties assigned to them by appellee (Tr. 159-164, 178-179, 212, 232 and Finding of Fact XX, Tr. 126).

Detailed written instructions, rules and procedures for handling these gasoline barges and check lists to be filled out as to the pumping operations had been prepared, issued and were being used by appellee before the accident. Exhibits 12, 13, 14, 15 (Tr. 86). In addition, there had been frequent conferences at which safety procedures and hazards involved in the operations of loading and discharging bulk gasoline cargoes from the barges had been discussed between the supervisory personnel and the maintenanceman and tankermen employed by appellee at Pasco (Tr. 200-203, 206, 208). Instructions had been given that the maintenanceman and tankermen were to call any electrical malfunction on the barges to the attention of the Supervisor of the Pasco terminal of appellee, and that any major electrical work was not to be undertaken by the maintenanceman but was to be

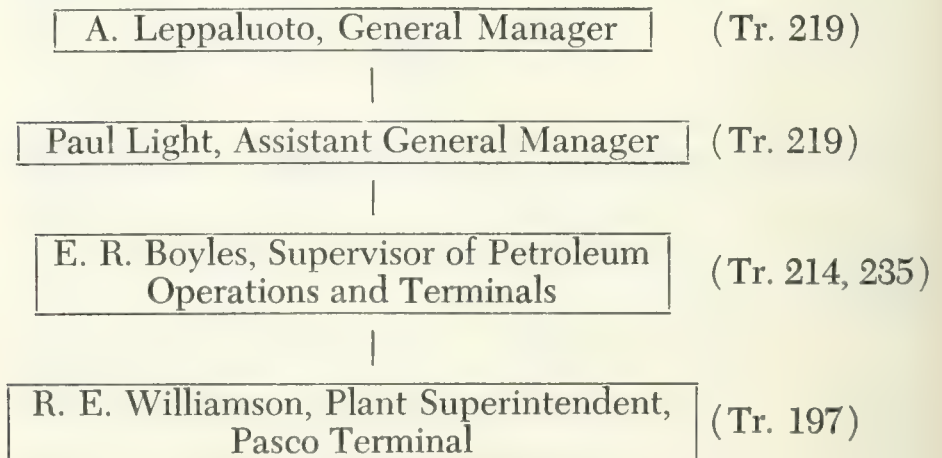


handled by the electrician at the repair yard maintained by appellee at The Dalles, Oregon (Tr. 202-203, 209-210, 212).

On the date of this accident, the maintenanceman and tankermen were complying with all written instructions, rules and regulations, and also with verbal instructions and orders (Tr. 182, 184, 186 and Finding of Fact XXIII, Tr. 127-128). All equipment required by the U. S. Coast Guard for use on gasoline barges or tank vessels was provided and was in use at the time of the accident (Tr. 70-71 and Finding of Fact XIII, Tr. 123-124).

After the maintenanceman replaced the circuit breaker switch on the barge, the switch on this circuit was cocked and turned on and the lights functioned and continued to function in a normal manner for a period of from three to four hours before the explosion occurred during the final stages of the operation of discharging gasoline from the barge to the shore tanks (Finding of Fact XVII, Tr. 125 and State Court Finding of Fact V, Tr. 68).

The chain of command or management-employee hierarchy in appellee's company at the time of the accident was as follows:



No officer, managing agent or supervisory employee of appellee was present aboard the BARGE 535 after its arrival at Pasco on the day preceding the accident. There had been no report to any of the management or supervisory personnel concerning any difficulty encountered by the maintenanceman or tankermen with the starboard electrical wiring circuit which resulted in replacement of the circuit breaker switch (Tr. 184-185, 203-205, 231-232 and Findings of Fact XVIII and XXI, Tr. 125-126).

### III.

#### **ARGUMENT IN SUPPORT OF FINDINGS OF FACT, CONCLUSIONS OF LAW AND FINAL DECREE**

##### **A. PRELIMINARY STATEMENT:**

In appellant's brief, it is recognized that the single question presented on this appeal is whether the findings of the District Judge entitled appellee to a limitation of liability under Title 46 U. S. Code § 183(a) (Br. 3).

It is the position of appellee that the single question raised in appellant's brief is a factual question which should be determined on the basis of application of the rule announced in 1954 by the U. S. Supreme Court in *McAllister v. United States*, (U.S. S.Ct., 1954) 348 U.S. 19, 99 L.ed. 20.

In its Specifications of Error, appellant takes specific exception to Findings of Fact XXV, XXVIII, XXIX, XXX and Conclusion of Law III (Br. 11-14). It also takes general exception to the Findings of Fact in their entirety and to the entry of judgment granting appellee a limitation of liability. Since appellant has taken no specific objection to Findings of Fact and Conclusions of Law other than as identified in its brief and mentioned hereinabove, it would appear that appellant has no real ground

for challenging the other Findings of Fact as made by the District Judge. *PACIFIC QUEEN*, (CA 9, 1962) 307 F.(2d) 700, 705 and footnote 5; *Rules of the U. S. Court of Appeals for the Ninth Circuit*, Rule 18 subdivision 2(d).

While the burden of proving that Findings of Fact are clearly erroneous is upon appellant and the trial court's findings must be accepted if supported by substantial evidence viewed most favorably to the appellee, *PACIFIC QUEEN*, (CA 9, 1962) 307 F.(2d) 700, 706, appellee will undertake to cite references to the evidence in the record supporting each of the specifically challenged findings. *Rules of the U. S. Court of Appeals for the Ninth Circuit*, Rule 18 subdivision 3.

B. FINDING OF FACT XXV as excepted to by appellant is as follows:

“That Petitioner had exercised due diligence and had adequately performed any duty or obligation resting upon it as barge owner to instruct and educate its employees concerning the operations of handling and discharging bulk gasoline from its floating equipment, including BARGE 535 or to warn its employees concerning any known or probable hazards relating to the electrical equipment and circuit breakers installed on BARGE 535.” (Tr. 128)

The record shows without contradiction that the following separate actions had been taken by appellee to instruct and educate its employees regarding the handling and discharging of bulk gasoline and to warn its employees concerning any *known or probable hazards* relating to the electrical equipment and circuit breakers on BARGE 535:

1. Detailed Rules and Regulations had been issued as of June 22, 1954 pertaining to procedures for handling

gasoline barges. Exhibit 12 (Tr. 86). These Rules and Regulations were in use and in effect at the Pasco terminal of appellee at the time of the BARGE 535 explosion (Tr. 227). There was a complete section on safety procedures (Tr. 225) and a section on barge unloading procedures (Tr. 226).

2. Individual Barge Inspection Reports were in use at Pasco and throughout appellee's system of terminals at the time of the accident. This form of report was to be filled out by the tankerman handling the loading or discharging operation and filed with the terminal office for appropriate review and action as required. These Inspection Report forms were in the nature of a check list and they contained a specific item requiring inspection and report "BEFORE AND DURING UNLOADING" as to the electrical wiring circuits on each barge and notation as to any corrective action taken or required by way of maintenance or repair. Exhibit 13 (Tr. 86).

3. Superintendent Williamson at the Pasco terminal had prepared detailed Barge Pumping Instructions. Exhibit 15 (Tr. 86). This document had been read and individually signed by the maintenanceman and all of the tankermen employed by appellee at Pasco before the BARGE 535 accident occurred (Tr. 200). There was specific instruction in this document requiring:

"If any discrepancy on the barge or the pumping of barge, stop pumping and contact man in charge."  
(Exhibit 15)

4. Plant Superintendent Williamson had periodically discussed safety and maintenance procedures with Supervisor Boyles (Tr. 203) and with the maintenanceman and tankermen employed at Pasco (Tr. 200, 208). It was



definitely understood between the supervisory personnel and the maintenanceman and tankermen that the latter employees were to call the attention of Superintendent Williamson to any electrical malfunction (Tr. 201-203, 209-210). Also, it was understood and specified that the maintenanceman and tankermen were to restrict their activities on the electrical systems of the barges to replacement of light globes, running cords and similar work and to refer any major electrical work to the company electrician at The Dalles shipyard operated by appellee (Tr. 183, 201-203), even though Superintendent Williamson felt that maintenanceman Oldfield was qualified to do more electrical work (Tr. 212).

5. Supervisor Boyles spent from two to three days of each week at the Pasco terminal and went aboard the gasoline barges on almost every such occasion (Tr. 209, 219). He discussed safety and maintenance procedures with the maintenanceman and tankermen (Tr. 220). The subject of electrical maintenance was discussed "at every meeting" (Tr. 221), and maintenance and repair of electrical wiring and circuits on the barges were discussed on "numerous occasions" (Tr. 228-229). It was clearly understood that employees at the Pasco terminal were not to undertake to splice any wiring or to install any new wiring on the barges (Tr. 229). Supervisor Boyles, although having had some past experience with circuit breakers, was not aware of any hazard of an intermittent short existing along the line after a circuit breaker had been replaced and the lights functioned apparently normally (Tr. 250). Boyles had experience as to replacement of such switches and knew that a reserve supply was maintained at the Pasco terminal for this purpose (Tr. 221-222).



Captain House, who testified as an expert witness for appellee, was the Operations Manager and Port Captain for Washington Tug & Barge Company at Seattle (Tr. 289). He had also served as Master and Engineer of vessels, as Port Engineer and in other capacities for his company (Tr. 289), which has been engaged since 1946 in the specialized operation of transportation of gasoline and other light petroleum products (Tr. 289-290). He was something more than a "tug boat captain," as described in appellant's brief (Br. 36). Witness House testified that upon the basis of his experience in marine transportation of gasoline and his familiarity with barge electrical wiring and circuit breakers, the instructions, particularly the written instructions contained in Exhibits 12, 13, 14 and 15, conformed to the usual and customary type of instructions that would be used by a prudent operator of such vessels carrying bulk petroleum products in this area (Tr. 314).

In the early case of the *ANNIE FAXON*, (CA 9, 1896) 75 Fed. 312, this Court considered a limitation of liability proceeding involving claims for death of passengers and crew members resulting from the explosion of the boiler on a vessel operated on the Snake River. The boiler had been tested and passed by the U. S. Steamboat Inspection Service about eight months before the casualty. A licensed marine engineer participated on behalf of the shipowner in the government inspection, and this engineer had thereafter supervised and checked certain boiler repairs. When the vessel was placed back in service, crew members, without knowledge of the owner or its supervisory personnel, continued to operate and use the boiler after certain of its elements had become defective. The trial court

granted limitation of liability, and upon appeal, this Court affirmed, stating in part:

“It was nevertheless held that the knowledge of the master, who had been charged by the owners with the duty of repairing the vessel, was not the knowledge of the owners, and that the owner may delegate to another the duty of suitably fitting out his ship, and thereby relieve himself from full liability, although such agent may have been negligent.”

ANNIE FAXON, (CA 9, 1896) 75 Fed. 312, 316.

On the appeal of the above case, it was argued that the shipowner was not entitled to rely upon inspection of the boiler by an “unskilled person.” In disposing of this contention, this Court had the following comments regarding the duties of a shipowner in respect to maintenance of vessels in a situation quite comparable to the present case:

“We are unable to perceive how there can be imputation of privity or knowledge to a corporation of defects in one of its vessel’s boilers, unless the defects were apparent, and of such a character as to be detected by the inspection of an *unskilled person*. The record fails to show that the defects were of this character. \* \* \* When we consider the purpose of the law which is under consideration, and the construction that has been given to it by the courts, it is obvious that the managers of a corporation whose business is the navigation of vessels are *not required to have the skill and knowledge which are demanded of the inspector of a boiler*. It is sufficient if the corporation *employ, in good faith, a competent person to make such inspection*. When it has employed such a person in good faith, and has delegated to him that branch of its duty, its liability beyond the value of the vessel and freight ceases, so far as concern injuries from defects of which it has no knowledge, and which are not apparent to the ordinary observer,

but which require for their detection the skill of an *expert*.” (Emphasis added.)

*ANNIE FAXON*, (CA 9, 1896) 75 Fed. 312, 314, 315.

The *ANNIE FAXON*, *supra*, has stood the test of time and critical review and has been cited with approval by other courts in more recent cases dealing with the same general question:

*Coryell v. Phipps*, (CA 5, 1942) 128 F.(2d) 702, 704;

*Petition of Canadian Pacific Railway (The PRINCESS SOPHIA)*, (WD Wash. ND, 1921) 278 Fed. 180, 188, affirmed (CA 9, 1932) 61 F.(2d) 339;

*The RAMBLER*, (CA 2, 1923) 290 Fed. 791;

*Petition of Val Marine Corp.*, (SDNY, 1956) 145 F. Supp. 551, 554.

In *The RAMBLER*, *supra*, the Court of Appeals for the Second Circuit considered questions as to an explosion accident and alleged negligence of supervisory personnel upon basic facts similar to those involved in the present case. In granting limitation of liability, the court referred to the “often quoted and approved decision of *The ANNIE FAXON*” in the Ninth Circuit. *The RAMBLER*, (CA 2, 1923) 290 Fed. 791, 792.

In *PERTH AMBOY NO. 1*, (SDNY, 1956) 144 F. Supp. 340, the court granted limitation of liability to an oil barge owner, holding that the owner’s Port Captain was not negligent in failing to seek “expert advice” as to how best to deal with an oil spill. The court found that the oil spill was due to the negligence of a subordinate employee of the owner who held a certificate from the U. S.



Coast Guard as a tankerman. The court said:

“On the other hand Johansen was a certified tankerman and there is not a scintilla of evidence that he was not completely qualified and competent \* \* \*.”

*PERTH AMBOY NO. 1*, (SDNY, 1956) 144 F. Supp. 340, 341.

C. FINDING OF FACT XXVIII as excepted to by appellant is as follows:

“That Petitioner was not in privity with any act or failure to act of the tankermen and maintenancemen employed by it which the Court in Cause No. 10527 may have found to have been the proximate cause of the accident.” (Tr. 129)

Maintenanceman Oldfield testified that he had not reported to and had not consulted with either Pasco Terminal Superintendent Williamson or Superintendent of Terminals Boyles regarding the difficulty encountered with the electric lighting circuit on BARGE 535 before this accident occurred on the early morning of December 16, 1958 (Tr. 184-185).

Superintendent of Terminals Williamson testified that he had not been aboard BARGE 535 after its arrival at Pasco and had not been informed by any of the employees working under him as to the problem encountered with the electric lighting circuit on BARGE 535 before the explosion occurred (Tr. 203-205).

Superintendent of Terminals Boyles testified that he had no knowledge or report regarding difficulty experienced by maintenanceman Oldfield and tankerman Bunce with regard to the starboard wiring circuit on BARGE 535 and that he was not present at Pasco at the time the accident occurred (Tr. 231-232).

Boyles testified that while he had more knowledge than the ordinary person regarding the electrical wiring systems and use of circuit breakers on petroleum barges such as BARGE 535 (Tr. 239-240), he was not aware that the tripping of the circuit breaker was a warning that something was “wrong with the *circuit* being served by this device” and “beyond this device.” (Tr. 240-241). Boyles testified that from his experience, he knew that the tripping of the circuit breaker might be caused by something within the conduit or circuit breaker box (Tr. 242, 250), and that from his experience, he had found that this was “quite often” the case (Tr. 242). Boyles testified that it was his belief and understanding that the circuit breaker itself functioned to protect against an arc caused by a short circuit (Tr. 244).

In addition, supervisor Boyles stated that he knew that maintenanceman Oldfield and tankerman Bunce were aware of the dual functions of circuit breakers as a switch and as a warning device (Tr. 248).

Expert witness Holt candidly conceded upon cross-examination by appellant’s counsel that after the circuit breaker had been replaced, the lights on such a wiring circuit might function in an apparently normal operation for three to four hours before an intermittent short would manifest itself, but he stated that such a circumstance was only “remotely possible” (Tr. 283-284).

Captain House, as an expert witness, testified that it was customary in the marine industry on equipment such as this for tankermen or maintenancemen to replace circuit breaker switches without calling for the services of a shore electrician (Tr. 303).



D. FINDING OF FACT XXIX as excepted to by appellant is as follows:

“That Petitioner was not negligent in failing to issue particular instructions or warnings to its maintenanceman and tankermen regarding proper procedures to follow in the event some difficulty or malfunction was encountered in the operation of electrical wiring circuits or circuit breaker switches aboard BARGE 535 while engaged in transporting, loading or discharging bulk gasoline products.” (Tr. 129)

Appellee operated its own repair yard, including an electric shop, at The Dalles, Oregon, at which place the company expected to perform any major electrical repair or maintenance work required on the barges (Tr. 218).

Captain House, who has had many years of experience in operation of similar tank vessels and barges on Puget Sound, stated that under circumstances such as those involved in this case, he would consider it appropriate to allow the maintenanceman or tankerman to replace a circuit breaker switch. If the switch again kicked out after such replacement, Captain House would then have expected the maintenanceman or tankerman to leave the circuit alone until a shoreside repairman or electrician could check it out. He stated that the replacement of a circuit breaker switch would be considered as “normal small maintenance” which the owner or operator of gasoline barges would expect to be performed by its maintenanceman or tankerman (Tr. 301-303). He also stated that there was no Coast Guard regulation prescribing procedures to follow in such cases (Tr. 294).

Expert witness Holt, who had many years of experience—primarily in marine electrical installations and repair—stated that the proper practice when a circuit break-

er switch on a vessel such as BARGE 535 kicked out would be to:

- (a) Make a visual inspection along the line; then
- (b) Attempt to reset the kicked off circuit breaker; then, if the circuit did not function properly
- (c) Change the circuit breaker switch in the unit.

If the lights on the wiring circuit then went on and continued to burn, expert witness Holt stated that he would assume the circuit breaker switch was faulty and that the condition had been corrected by replacement of the same (Tr. 269-275). Mr. Holt stated that this was the customary practice followed by operators of equipment in the marine industry and that it was not a customary practice to call for the services of shore electricians or licensed electricians before undertaking the above procedures (Tr. 275-278).

In fact, witness Holt testified that to undertake an Ohmmeter or Megger test of the electrical wiring circuit before replacing the circuit breaker switch, as had been earlier suggested by counsel for appellant, would be inherently dangerous because of the hazard that an arc or sparks from a short circuit in the line might thereby be created (Tr. 277). Finally, expert witness Holt testified that in his opinion, the procedure followed by maintenanceman Oldfield and tankerman Bunce on BARGE 535 was proper (Tr. 273-275) and that it would be safe to continue using the lighting circuit on the barge without further testing (Tr. 276).

During the examination of expert witness Holt, in the course of colloquy with counsel regarding the line of examination of this expert electrician witness, the trial

judge stated:

“THE COURT: How does he find it? Suppose he tested and never did find it, wasn't he at fault? If it is intermittent, it is just as hard for an electrician to find it as anyone else.” (Tr. 266)

This observation by the District Judge eloquently demonstrates the problem facing appellee in trying to more specifically instruct, direct or warn its employees as to safety procedures or proper action to take with regard to a hazard of which the supervisory personnel were unaware, and which even an expert electrician might find difficult to locate.

E. FINDING OF FACT XXX as excepted to by appellant is as follows:

“That under all the circumstances, Petitioner exercised due diligence and reasonable care as to instructing its employees regarding operation, repair and maintenance of the electrical equipment, including circuit breakers, on BARGE 535 before and at the time of the accident on December 16, 1958, and was not negligent with respect thereto.” (Tr. 129-130)

The evidence in support of this finding overlaps the evidence previously referred to in support of Findings of Fact XXV and XXIX, which evidence is equally applicable here.

As pointed out by the trial judge, the determination of whether due diligence and reasonable care were used by appellee, and the nature and scope of instructions or warnings to be given, would depend to some extent upon the experience and qualifications of the maintenanceman and tankermen (Tr. 173).

Prior to the time of this accident, maintenanceman Oldfield had about fifteen years of experience in mechanical maintenance work, including some electrical work and including about six years with appellee and its predecessor as maintenanceman at the Pasco terminal (Tr. 159-163). He was regarded as a competent maintenanceman by his superiors, Mr. Williamson as Superintendent of the Pasco terminal (Tr. 199, 212) and Mr. Boyles, who was Supervisor of the Terminals (Tr. 232). Oldfield had prior experience with maintenance work on the lighting or wiring systems on these gasoline barges (Tr. 163-164), but he followed the established company practice of referring major electrical work or actual repair of wiring systems to the company electrician at The Dalles (Tr. 164).

Oldfield acknowledged in his testimony that he had received verbal instructions from his superiors in the company regarding safety procedures and precautions on maintenance and repair, including electrical systems on the barges (Tr. 182-183). On some previous occasions, he had referred such electrical work for accomplishment by the company electrician (Tr. 184). Both the written instructions, rules and regulations (Exhibits 12, 13, 14 and 15) and the verbal instructions and orders were being carried out and complied with in the course of the work performed by Oldfield and Bunce several hours before the explosion occurred (Tr. 182, 184, 186).

Oldfield was in charge of the tankermen (Tr. 166). Working with tankerman Bunce, he replaced the circuit breaker switch, after first making a visual inspection along the starboard wiring circuit on BARGE 535 and finding no breaks or defects (Tr. 72, 174-176, 194).



F. CONCLUSION OF LAW III as excepted to by appellant is as follows:

“That Petitioner has sustained the burden of proving that the explosion and fire involving BARGE 535 at the Port of Pasco on December 16, 1958 occurred without the privity or knowledge of Petitioner, its corporate officers, managing agents or supervisory personnel in the managerial hierarchy.” (Tr. 131)

This Court, when considering a similar question (then a *de novo* hearing on an admiralty appeal) as to the adequacy of rules and regulations pertaining to navigation, boat drills and other safety procedures in a limitation of liability proceeding, quoted in *The PRINCESS SOPHIA*, (CA 9, 1932) 61 F.(2d) 339, 346, from the United States Supreme Court decision in *LA BOURGOGNE*, (U.S.S.Ct., 1908) 210 U.S. 95, 126, 127, 52 L.ed. 973, 988, as follows:

“The petitioner having shown the promulgation of regulations for the conduct of its business, which exacted a compliance by the captains of its vessels with the international rules, we think the burden of proving that the rules were not promulgated in good faith or that a wilful departure from their requirements was indulged in, and was brought home to, or countenanced by, the petitioner, was cast upon the claimants, and that the court properly held that that burden was not sustained by the evidence.”

*LA BOURGOGNE*, 210 U.S. 95, 126, 127, 52 L.ed. 973, 988.

Based upon the facts as admitted, or not disputed by appellant in the Pretrial Order (Tr. 63-72), the evidence as a whole and particularly as referred to in the previous subsections herein, and the Findings of Fact as made by the trial court, we submit that the evidence does support this conclusion and that it is not *clearly erroneous* as claimed by appellant.



## IV.

## ANSWER TO ARGUMENTS OF APPELLANT

Appellant's first argument is to the effect that the Admitted Facts in the Pretrial Order, coupled with the allegedly clear showing of a total failure to adequately instruct the subordinate employees, establish *privity and knowledge as a matter of law* (Br. 16).

At the outset, appellee contends that the above statement is inaccurate and that the record is replete with evidence in the form of admitted or undisputed facts, testimony of witnesses and exhibits to show that the company had adequately instructed its employees.

The agreed Order of the District Court (Tr. 27-29) based upon Stipulation by appellant (Tr. 29-32) expressly reserved all questions as to appellee's right to limitation of liability under Title 46 U.S. Code § 183(a) for trial by the U. S. District Court after the State Court determined if there was any initial liability and also determined damages.

The findings and judgment of the State Court, insofar as they exceeded the restrictions of the Stipulation and District Court Order, or insofar as they encroached upon the limitation of liability question reserved for adjudication by the District Court, were not and could not be *res judicata*. The Stipulation expressly provided that *appellant waived* any claim of *res judicata* (Tr. 32, Sec. 6).

Having agreed to waive claim of *res judicata*, appellant cannot validly argue that the State Court findings decided the question of privity, knowledge or negligence of management personnel of appellee. It was for this reason that appellee *did not concede* the binding effect

of State Court Finding of Fact VI, and this was brought out by appellee's (petitioner's) Contentions Nos. 2, 4 and 6 in the Pretrial Order (Tr. 74-75).

Appellee went further in its Contentions by pointing out that the Amended Complaint of appellant in the State Court action did *not* allege any breach by appellee of any duty to either instruct, educate or warn its employees concerning use, maintenance and repair of circuit breakers. As pointed out in appellee's (petitioner's) Contention No. 3, this issue was not injected into the State Court action by appellant until after the trial proceedings, when a post-trial amendment was sought by Motion, which was vigorously contested by appellee (Tr. 74-75 and Br. 9).

It was a factual question as to whether the foreseeability of the explosion on BARGE 535 was related to any negligence of appellee at the management level. The District Court in trial of the limitation of liability issue decided this question in favor of appellee, although the State Court had found to the contrary (Finding of Fact VI, Tr. 51-52), this being a finding which appellee *did not concede to be binding* in the Pretrial Order in the limitation case before the District Court (Tr. 74-75). We submit that the evidence amply supports District Court findings on this point as discussed in detail in early sections of this brief.

The statement under heading 5 on page 15 of appellant's brief that there was "undisputed evidence" of appellee's failure to issue instructions as to safe practices in the event of malfunction of electrical systems is simply not true, as shown by numerous citations and references to the record as previously made. As to the statement by ap-

pellant on page 21 of its brief that appellee's evidence as to custom with respect to electrical malfunctions was "squarely met and flatly contradicted" by appellant, it would appear that the District Judge chose not to accept and follow the testimony and opinion of the *only witness* called by appellant. In fact, it is later suggested in appellant's brief that the testimony of this one witness (Kniseley) be "totally disregarded" by this Court (Br. 36).

The statement by appellant (Br. 20) that appellee had employed persons with insufficient training or skill for this particular job is not correct and is contrary to Findings of Fact XX, XXVI, XXIX and XXX (Tr. 126-130), which findings are clearly supported by the evidence presented at time of trial. Finding of Fact XX expressly covers the point that the tankermen and maintenance-man employed by appellee were "competent and experienced as to the duties required of them" (Tr. 126), and this finding was not claimed erroneous when appellant took exceptions to specific findings (Br. 11-14) as required by Rule 18 subdivision 2(d) *Rules of the U. S. Court of Appeals for the Ninth Circuit*.

Having in mind the extensive written instructions, rules and regulations issued and the verbal instructions and conferences of supervisory personnel with the maintenance-man and tankermen regarding the hazards of these operations, the use and maintenance of electrical equipment and the procedures to be followed, it is not understood how the appellant could now contend that "appellee's managerial personnel *gave no attention whatsoever* to the matter of precautions to be taken by its subordinate employees in the wake of electrical malfunctions" (Br. 21).

The quotation by appellant from 155 A.L.R. 157, as



contained in the decision of this Court in *Alaska Freight Lines v. Harry*, 220 F.(2d) 272, 275, is not disputed (Br. 23). It should be noted, however, that this Court included two additional sentences in its quotation in the above decision from the annotation, which are not contained in appellant's brief. These are:

"It is well settled that foreseeability or probability of harm is an essential element of negligence. The duty to use care and the liability for negligence depend upon the tendency of the acts under the circumstances as *they are known, or should be known*, to the actor." (Emphasis added.)

*Alaska Freight Lines v. Harry*, 220 F.(2d) 272, 275.

On the second portion of the argument in its brief, appellant contends that the District Court finding that liability should be limited is *clearly erroneous as a matter of fact* (Br. 24).

No mention is made by appellant in its brief of the controlling effect of the decision by the U. S. Supreme Court in *McAllister v. United States*, (U.S. S.Ct. 1954) 348 U.S. 19, 99 L.ed. 20, wherein it is stated:

"In reviewing a judgment of a trial court, sitting without a jury in admiralty, the Court of Appeals may not set aside the judgment below unless it is clearly erroneous. \* \* \* A finding is clearly erroneous when 'although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed,' (citing cases)."

*McAllister v. United States*, 348 U.S. 19, 20, 99 L.ed.(2d) 20, 24.

This Court has recognized that the burden of proving that findings of fact are clearly erroneous is upon appel-

lant. As stated in the *PACIFIC QUEEN*, (CA 9, 1962) 307 F.(2d) 700:

“\* \* \* it is not incumbent upon *appellees* to persuade this court that the District Court’s findings of fact are correct; on the contrary, the *appellants* must persuade this court that the District Court’s findings of fact are, as specified by appellants, clearly erroneous.”

*PACIFIC QUEEN*, 307 F.(2d) 700, 706.

The findings of the District Court in this case that appellee’s management personnel were not negligent involve findings of fact which are entitled to the protection of the “clearly erroneous” rule. In this Circuit, it is recognized that findings as to negligence or lack of negligence or unseaworthiness are findings of fact. *Ramos v. Matson Navigation Company*, (CA 9, 1963) 316 F.(2d) 128, 131; *Pacific Towboat Co. v. States Marine Corporation*, (CA 9, 1960) 276 F.(2d) 745, 752. Negligence becomes a question of law only where the facts are undisputed and but one conclusion can be reasonably drawn from such admitted or undisputed facts. *Yellowstone Pipe Line Company v. Kuczynski*, (CA 9, 1960) 283 F.(2d) 415, 418, 419.

It is asserted in appellant’s brief that there was no conflicting evidence concerning negligence of appellee’s management personnel and that, accordingly, the District Court’s findings as to negligence were clearly erroneous (Br. 35). A similar suggestion was raised before and rejected by this Court in *Gypsum Carrier, Inc. v. Handelsman*, (CA 9, 1962) 307 F.(2d) 525. The statements by this Court in rejecting this point would seem to be equally applicable to the present situation:



“Thus we need not consider whether a trial court’s conclusion as to the existence of negligence is generally to be classified as one of fact or of law. Clearly enough in the present case it reflected a factual determination from conflicting evidence. There is nothing to indicate, as appellant suggests, that the District Court tested appellee’s conduct against an improper standard of care.”

*Gypsum Carrier, Inc., v. Handelsman*, 307 F.(2d) 525, 528.

The following factors must be considered with respect to the application of the “clearly erroneous” rule:

1. District Court findings will not be disturbed unless they are clearly erroneous, regardless of what decision this Appellate Court might reach were it considering the same evidence in the first instance. *Puget Sound Pulp & Timber Co. v. O’Reilly*, (CA 9, 1956) 239 F.(2d) 607, 609.

2. This Appellate Court will view the evidence in the light most favorable to the prevailing party. *PACIFIC QUEEN* (CA 9, 1962) 307 F.(2d) 700, 706; *Axelbank v. Rony*, (CA 9, 1960) 277 F.(2d) 314, 316.

3. Appellee, as the party prevailing below, will be given the benefit of all inferences that may reasonably be drawn from the evidence. *PACIFIC QUEEN*, (CA 9, 1962) 307 F.(2d) 700, 706. *Sherman v. Lawless*, (CA 8, 1962) 298 F.(2d) 899, 902.

4. The burden of proof in establishing that findings of fact are clearly erroneous is upon the appellant. *PACIFIC QUEEN*, (CA 9, 1962) 307 F.(2d) 700, 706.

5. If this Court determines that the record is susceptible to two inconsistent inferences, it will not disturb the

findings, or favor the party (appellant) upon whom rests the burden of proof. *Sherman v. Lawless*, (CA 8, 1962) 298 F.(2d) 899, 902.

6. The evaluation and determination of ambiguous or conflicting testimony is to be made by the District Court and its determination will not be set aside on review unless this Court finds that it is "clearly erroneous." *Guzman v. Pichirilo*, (U.S.S.Ct., 1962) 369 U.S. 698, 702, 8 L.ed.(2d) 205, 209.

7. This Court will give due regard to the opportunity of the District Court to judge the credibility of the witnesses. *Gypsum Carrier, Inc., v. Handelsman*, (CA 9, 1962) 307 F.(2d) 525, 529.

8. This Court will not upset the factual findings of the District Court unless it is left with the definite and firm conviction that a mistake has been committed. *McAllister v. United States*, (U.S.S.Ct. 1954) 348 U.S. 19, 20, 99 L.ed. 20, 24.

In seeking to show that the District Court findings as to privity and knowledge were "*clearly erroneous as a matter of fact*," appellant attempts to draw an analogy between the facts in this case and those in *States Steamship Co. v. United States, et al. (The PENNSYLVANIA)*, (CA 9, 1958) 259 F.(2d) 458 with particular reference to the decisions by this Court upon the first and second rehearings in that case where the decree of the District Court was reversed and limitation of liability was denied.

It seems obvious that the factual situations in these two cases are quite different and, therefore, the rationale

for the ruling denying limitation in *States Steamship Co.*, *supra*, would not be pertinent in this case. In *States Steamship Co.*, this Court found strong evidence of privity, knowledge, lack of due diligence and personal negligence of supervisory personnel of the shipowner. In the course of the opinion on the second rehearing, it is stated:

“Our former opinion sufficiently details what the evidence showed as to Vallet’s [port engineer] *connection with this crack problem from beginning to end* and his *complete knowledge* of the crack sensitiveness of the vessel.” (Bracketed ours and emphasis added.)

*States Steamship Co. v. United States, et al.*, (CA 9, 1958) 259 F.(2d) 458, 473.

Thus, while this Court found clear and convincing evidence of “complete knowledge” of the defect and danger in *States Steamship Co.*, *supra*, such evidence is wholly lacking in this case.

Appellant concedes in its brief that the facts in *States Steamship Co.*, *supra*, are “quite different” than those in the present case (Br. 17). Appellant also concedes in its brief that Supervisor Boyles of appellee “had no knowledge of the hazard” with respect to an intermittent short circuit (Br. 25).

Appellant undertakes in its brief to establish foreseeability by management personnel of appellee by stating that the danger of re-energizing the line after replacing a circuit breaker should have been “self evident to persons at the management level” of appellee; yet, in the following paragraphs, appellant points out that maintenanceman Oldfield, who had considerable experience with electrical wiring and circuit breakers, was not aware of

the particular hazard of an intermittent short circuit, which the State Court found was the cause of the explosion (Br. 26). Appellee did give warnings and issue instructions to its maintenance and operations personnel with respect to electrical malfunctions, notwithstanding the unsupported contention by appellant to the contrary (Br. 27).

Here again, the early statements by this Court in the *ANNIE FAXON*, (CA 9, 1896) 75 Fed. 312, 315 are important. A shipowner is not required to have the skill of an "expert" but sufficiently discharges its obligation if it employs "competent" persons to inspect and maintain its floating equipment. The evidence in this case shows such persons were unaware of the particular defect or hazard which is found to have caused the explosion and damage.

Lack of knowledge or means of knowledge is therefore the important and distinguishing factor between this case and *States Steamship Co. v. United States, et al., supra*. *The SILVER PALM*, (CA 9, 1937) 94 F.(2d) 776 and other cases relied upon by appellant are likewise distinguishable on the same basis (Br. 32-34).

In the course of the argument in its brief, appellant raises at several points a question as to the admissibility of evidence offered by appellee through expert witnesses as to custom or practice followed in the marine petroleum transportation industry with regard to instructions and precautions taken against hazards of explosion, and as to methods of dealing with electrical malfunctions (Br. 21, 28-30, 36).



Appellee does not disagree with the statement of the general rule by appellant that custom or practices of an industry are never *controlling* on the question of negligence (Br. 28). However, in this case, the operations and electrical equipment being considered were not of a type within the common knowledge of laymen, and it was on this basis that appellant offered expert testimony *as an aid* to the trial court in determining foreseeability and the proper standard of care (Tr. 305). The trial judge stated in its opinion that the evidence was received and considered on this basis (Tr. 344).

In a fairly recent action considered by this Court, damages were sought against the government for death of a child electrocuted while climbing a fence surrounding a power substation. The government had introduced expert testimony, over the objection of the plaintiff, by three electrical engineers concerning the custom and practice of electrical companies in providing safeguards around electric power substations. This Court affirmed the District Court's judgment in favor of the defendant, and on the question as to the admissibility of the testimony of such expert witnesses as to the custom in the electrical industry, it stated:

*"Such evidence is admissible and competent for consideration by the trier of fact on the issue of whether or not negligence has been proven (citing cases). This evidence is not controlling on the question of whether the defendant exercised due care under the circumstances, and the District Court in its opinion has so stated.*

*"The District Court further stated 'customary practice is not ordinary care; it is but evidence of ordinary care' (citing cases). We see no objection to the ad-*



mission of this testimony for the purposes stated.” (Emphasis added.)

*Johnson v. United States*, (CA 9, 1959) 270 F.(2d) 488, 491.

See also *Young v. Aeroil Products Company*, (CA 9), 1957) 248 F.(2d) 185, wherein evidence had been introduced at the trial as to the customary manner of operating or handling an elevator. In affirming the District Court’s judgment in favor of the defendant, this Court stated as to the evidence of custom:

“*Customary conduct is an indicia of reasonable conduct*, but the two are not equated either in fact or in law. The District Court could well have regarded this non-compliance with the employer’s orders as negligent behavior on the part of the decedent. *At least we cannot say under the circumstances that such a finding is clearly erroneous.*” (Emphasis added.)

*Young v. Aeroil Products Company*, (CA 9, 1957) 248 F.(2d) 185, 189.

In an action for wrongful death based on alleged failure to provide an employee with reasonably safe appliances, and failure to warn, to instruct, or to establish adequate rules, another appellate court affirmed the directed verdict entered by the District Court in favor of the defendant and stated:

“Ordinarily, fulfillment of that duty is established when it appears that the *employer conformed to the common usages of the industry*, for one cannot ordinarily be said to be negligent if he does that which ordinary men, like situated, do. He is not bound to discard standard appliances whenever a better one is put on the market (many cases cited).” (Emphasis added.)

*Grammer v. Mid-Continent Petroleum Corporation*, (CA 10, 1934) 71 F.(2d) 38, 40.

This rule has even been recognized by another Federal appellate court with respect to the custom of inspection of the electric power lines in an action involving the technical features and use of an electric circuit breaker. *Dunagan v. Appalachian Power Co.*, (CA 4, 1929) 33 F.(2d) 876. In rejecting plaintiff's contention that the trial court had committed error in admitting testimony of expert witnesses as to the customary method of inspection of power lines, the Fourth Circuit stated:

“Objection was also made to certain testimony of these witnesses as to the custom of other companies in making inspection; *but this testimony was clearly competent*. It is true that the question of the exercise of due care is not to be determined solely with reference to the custom of other companies, *but evidence as to such custom is certainly competent for consideration by the jury upon that question.*” (Emphasis added.)

*Dunagan v. Appalachian Power Co.*, (CA 4, 1929)  
33 F.(2d) 876, 878, 879.

It is not understood why, or for what purpose, appellant refers to certain Coast Guard regulations in its brief (Br. 30). The facts not disputed in the Pretrial Order clearly establish that appellant was taking all precautions required by the U. S. Coast Guard in connection with the operation, maintenance of and the equipment aboard BARGE 535 (Tr. 70-71). The barge had undergone and passed annual inspection by the U. S. Coast Guard less than two weeks before the accident in question (Tr. 71). These facts were incorporated into Findings of Fact XIII and XIV (Tr. 123-124), to which findings appellant took no specific exception. Rule 18 Subdivision 2(d), *Rules of*

*the U. S. Court of Appeals for the Ninth Circuit.*

All of the witnesses testified that there were no other Coast Guard regulations applicable to this operation and this type of equipment, and that the Coast Guard regulations did not require that a licensed electrician be used in performing such work as checking an electrical wiring circuit or replacing a circuit breaker switch unit on BARGE 535 (Tr. 207, 230, 252-253, 256, 294).

In fact, this point was never raised by appellant during the trial of the action and no contention or issue of fact or law was presented to the trial court which would suggest that there had been any failure by appellee to comply with any U. S. Coast Guard regulations.

Appellant devotes several pages at the conclusion of the argument in its brief to the subject of *res ipsa loquitur* (Br. 36-38). Counsel for appellant well know that their initial contention in the State Court action as to the application of *res ipsa loquitur* was expressly abandoned by appellant and that at the conclusion of the State Court trial, appellant moved to amend its Complaint to allege specific negligence of management personnel in failing to issue instructions to its employees as the *sole ground* upon which a recovery was sought (Br. 8-9, Tr. 47, 49). We therefore fail to see any materiality to the discussion of *res ipsa loquitur* in appellant's brief.

**CONCLUSION**

We respectfully submit that the Findings of Fact of the District Judge are not "clearly erroneous" but are fully supported by the evidence in the record. In addition, the Conclusions of Law correctly apply the legal principles which should control in this case. The Final Decree granting limitation of liability to appellee should be affirmed.

Respectfully submitted,

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**CERTIFICATE**

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

*Thomas F. Paul*

THOMAS F. PAUL

*Proctor for Appellee*



No. 18644

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IN THE  
**United States**  
**Court of Appeals** **FILED**  
For the Ninth Circuit **AUG 1 1963**

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PORT OF PASCO,  
a municipal corporation,

vs.

PACIFIC INLAND NAVIGATION  
CO., INC.

*Appellant,*

*Appellee.*

**FRANK H. SCHMID, CLE**

No. 18644

*On Appeal from the District Court of the United  
States, for the Eastern District of Washington,  
Northern Division*

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**APPELLANT'S REPLY BRIEF**

---

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**APPELLANT'S REPLY BRIEF**

---

**1. QUALIFICATIONS OF A COAST GUARD CERTIFIED TANKERMAN.**

Despite what appellee has to say in its brief as to instructions allegedly given its tankermen regarding the hazards associated with electrical malfunctions on its gasoline barges, the fact is, as we will discuss in more detail at a later point, that appellee gave no positive instructions in this area, but simply relied upon its tankermen to deal instinctively with any such problems. In what must be an effort to justify

this reliance on its tankermen, appellee went to considerable lengths in the record and in its brief to point up that these men, Oldfield and Bunce, had been issued certificates as tankermen by the United States Coast Guard.

Thus a consideration of the Coast Guard requirements for such a certificate would seem to be indicated, and these are to be found in Title 46, Code of Federal Regulations, §12.20, where, under "General Requirements," the applicant for such a rating is only required to furnish satisfactory evidence "that he is trained in, and capable of performing efficiently the necessary operations on tank vessels *which relate to the handling of cargo*" (Italics ours). The "Examination Requirements" thereafter set forth in the regulations are as follows:

"An applicant for certification as tankerman must prove to the satisfaction of the Coast Guard by an oral or written examination conducted only in the English language, that he is familiar with the general arrangement of cargo tanks, suction and discharge pipe lines, valves, cargo pumps and cargo hose, and has been properly trained in the actual operation of cargo pumps, all other operations connected with the loading and discharging of cargo, and the use of fire extinguishing equipment."

Nowhere in the Coast Guard regulations is there any requirement that a certificated tankerman should have any knowledge concerning electrical circuits or the function of safety devices such as circuit breakers, or that they should demonstrate an ability to cope with electrical malfunctions. If we were here



concerned with a safety problem involving the malfunction of the valves or pipe lines, then appellee might with some justification claim the right to assume that its certificated tankermen could, on their own and without benefit of instructions from management, safely deal with such a problem. But certainly appellee had no right to so assume with respect to problems associated with electrical circuits.

It is worthy of note that appellee's witness, Captain House, who occupied a supervisory position with Washington Tug & Barge Company of Seattle, and on whom appellee heavily relies, testified that he, like appellee, did not instruct his employees as to dealing with electrical malfunctions because—

“I knew that these men did not have to be told certain things because when they get their certificate from the Coast Guard they are well versed in safety and this is, of course the electrical system, the exhaust system, the bonding cable, etc. Many things on a gas barge the average layman would not understand because the man holds a certificate he knows when he is within a safe or unsafe area in what he is doing” (Tr. 311).

Later Captain House conceded that he did not know to what extent the Coast Guard investigates the qualifications or capabilities of a man before licensing him as a tankerman (Tr. 313-314). Thus Captain House and his company are guilty of the same carelessness as appellee in assuming anything concerning their employees' capabilities in the electrical field simply on the basis of their certification as tankermen by the Coast Guard.

## 2. STATEMENTS IN APPELLEE'S BRIEF WHICH ARE UNSUPPORTED BY THE RECORD.

Appellee's brief abounds with statements either totally without support in the record or which represent an unjustifiably liberal interpretation of matters contained in the record. Space limitations do not permit us to deal separately with all of these instances, but we will here refer to those unsupported statements having to do with matters of vital importance to appellee's position.

(a) At page 3 of its brief, appellee says:

"Instructions had been given that the maintenance man and tankermen were to call *any* electrical malfunction on the barges to the attention of the supervisor of the Pasco terminal of appellee \* \* \*."

There is absolutely nothing in the record which justifies this statement. The supervisor of appellee's Pasco terminal, Mr. Williamson, testified as follows:

"Q. And what was the instruction or orders which were given to Mr. Oldfield concerning such work? A. Anything that he felt he could not do, he was not capable of doing, to contact me and we would go from there" (Tr. 202).

He further testified as follows:

"Q. Well, Mr. Williamson, you had never instructed Mr. Oldfield to call to your attention any electrical malfunction he encountered? A. Yes sir. Q. You had instructed him to tell you if he had trouble with it? A. Major problems. Q. Well, did you make any attempt to tell Mr. Oldfield what he should consider a major problem? A. As a maintenance man he knewed what

on our barges. Q. He knew what it would be? You felt that he knew so you did not tell him what you considered a major problem? A. That is correct. Q. I see. As a matter of fact, what you had instructed him to do in your own words as you testified to previously in this case, you had told him to try to fix what he could. A. Exactly. Q. That was your very words, wasn't it? Do you recall that was your very words in the earlier trial, that you simply told Mr. Oldfield to try to fix what he could? A. To repair what he could, what he feels in his own mind was. Q. I see, so there was no reason for Mr. Oldfield to come and tell you about this replacement of the circuit breaker that he undertook, was there? A. No sir. Q. No, he was following your instructions, wasn't he. A. Yes sir" (Tr. 209-211).

Mr. Oldfield testified:

"Q. Well, Mr. Oldfield, in substance, what your instructions had been prior to this explosion from Mr. Williamson, who was your manager at Pasco, or Mr. Boyles, who was the superintendent from Vancouver, I believe in substance your instructions were to fix what you could, wasn't that about it? A. That is right. Q. And they left it to your judgment, didn't they, as to what you were to do in the face of an electrical malfunction, you yourself to make the decision as to how far you should go. A. Yes. Q. Yes, and that was in accordance with their instructions to you, wasn't it? A. Yes" (Tr. 185-186).

(b) At page 5 of its brief, appellee says:

"There had been no report to any of the management or supervisory personnel concerning any difficulty encountered by the maintenance-man or tankermen with the starboard electrical wiring circuit which resulted in replacement of the circuit breaker switch."

This same statement is repeated elsewhere and appears to us to represent an attempt to suggest that Oldfield and Bunce were derelict in their duty or violated some instruction in failing to report the incident. The fact of the matter is, however, that Oldfield and Bunce made no report of it for the simple reason that they had never been told to report such matters. Rather, as just pointed out, Oldfield had been told "to fix what he could," and as Supervisor Williamson testified, there was no reason for Oldfield to report the replacement of the circuit breaker which he undertook (Tr. 210-211).

(c) At page 8 of appellee's brief, it is again said:

"It was definitely understood between the supervisory personnel and the maintenance man and tankermen that the latter employees were to call the attention of Superintendent Williamson to any electrical malfunction."

We have already dealt with this misstatement. There is utterly no testimony in the record that these subordinate employees were ever instructed to report "*any* electrical malfunction." Rather, as the record clearly reveals, it was left up to Oldfield to decide whether any trouble was of sufficient importance to report and if, in his untrained judgment, he considered the problem less than a major one he was to attempt to deal with it without reporting (Tr. 185-186, 209-211).

(d) Also at page 8, appellee says:

"Also, it was understood and specified that the maintenance man and tankermen were to restrict



their activities on the electrical system on the barges to replacement of light globes, running cords and similar work. \* \* \*"

Again it would seem that appellee is attempting to suggest that these subordinate employees, in replacing the circuit breaker, were violating instructions so as to place the fault for the explosion beyond the privity of appellee corporation. The vice of the foregoing statement lies in the inclusion of the maintenance man (Oldfield). Mr. Williamson's testimony on this point was in fact as follows:

"Q. And what instructions were given to these personnel regarding those items? A. Well, the instructions were to replace light globes, running light cords, replace, anything that was major, Mr. Oldfield would be called in to check it over" (Tr. 201).

The record most certainly does not support any statement that *Oldfield* was to so restrict his activities on the electrical systems. Rather, as previously pointed out, he was given a general license to "fix what he could" (Tr. 185, 210).

(e) At page 13, appellee says:

"In addition, Supervisor Boyles stated that he knew maintenance man Oldfield and tankerman Bunce were well aware of the dual functions of circuit breakers as a switch and as a warning device."

It is true that Mr. Boyles, in the course of cross-examination, testified to the effect that he did not advise or discuss with these subordinate employees the dual function of circuit breakers, and volunteered



that “they did not need to be told, they knew that as well as I did” (Tr. 248).

By this indirect route appellee is attempting to suggest to this Court that Oldfield and Bunce did have an awareness of the dual function of these devices, whereas they at no place so claimed, *and the binding finding of the State Court was that these men did not have such knowledge* (Tr. 68).

(f) At page 17 appellee attempts, by various statements, to contend that Mr. Oldfield had considerable skill as an electrician. The fact was, as testified to by Mr. Oldfield, that he had been engaged in general maintenance work throughout his working life except for a period of two years during which he was employed by the California Oregon Power Company as an electrician’s helper or “grunt,” which job involved the passing of tools to the linemen who were stringing dead transmission lines (Tr. 190). Mr. Oldfield frankly acknowledged that his qualifications in electrical maintenance were limited to simple things such as replacement of sockets or switches, and Supervisor Boyles did not regard him as a skilled or qualified electrician (Tr. 191, 247).

(g) Also at page 17 appellee says:

“Oldfield acknowledged in his testimony that he had received verbal instructions from his superiors in the company regarding safety procedures and precautions on maintenance and repair including electrical systems in the barges.”

Appellee cites Tr. 182-183 in support of this state-

ment, but there is nothing on those pages or elsewhere in the record as to any instructions of any kind to Oldfield as to *safety procedures and precautions* with respect to the *electrical systems*. Mr. Oldfield simply testified that his instructions were “to do no major repair” and to “fix what he could” (Tr. 183). Supervisor Williamson agreed that these were his instructions to Oldfield (Tr. 202, 210).

(h) At page 26 appellee asserts that Oldfield “had considerable experience with electrical wiring and circuit breakers.” There is utterly nothing in the record to support any claim that Oldfield had any experience whatsoever with electrical wiring or circuit breakers, or any experience at all in the electrical field beyond simple maintenance, and this statement, like so many others made by appellee in its brief, is nothing more than an obvious attempt to ignore and at the same time contradict the State Court’s binding finding of fact which placed beyond issue the extent of Mr. Oldfield’s knowledge of the function of circuit breakers as safety warning devices.

(i) At page 27 of appellee’s brief, it is said, “appellee did give warnings and issue instructions to its maintenance and operations personnel with respect to electrical malfunctions notwithstanding the unsupported contention of appellant to the contrary.” As to this we again say, without fear of successful contradiction from the record, that there is not one iota of testimony as to any *warnings or instructions* as to electrical *malfunctions*. There is some vague

testimony that electrical *maintenance* was discussed in meetings, but specifically on this critical issue there is the testimony of all appellee's witnesses, supervisory and subordinate, that the sum and substance of the instructions to Mr. Oldfield were to "fix what he could" and to do "no major repair," it being left entirely to Mr. Oldfield to determine what constituted major repair work.

### 3. APPELLEE'S ARGUMENT IN SUPPORT OF FINDINGS, CONCLUSIONS AND DECREE (Appellee's Br. pp. 5-18).

#### (a) Appellee's Preliminary Statement.

In the opening paragraph at this point, appellee completely misstates our basic position. The single question presented by this appeal is not "whether the findings of the District Judge entitled appellee to a limitation of liability" as appellee suggests, but rather, as our opening brief clearly shows, whether the findings themselves are justified by the record *including the admitted facts contained in the pre-trial order*. This misstatement is in line with appellee's total failure to refer at any point in its brief to the pre-trial order, or to the State Court proceedings to the extent that those proceedings were binding and conceded to be binding on appellee.

The findings of the District Judge were, of course, prepared by appellee's counsel and in many respects are directly contrary to the admitted facts contained in the pre-trial order. We will presently discuss some

of these instances. However, we trust that this Court will not be misled by the opening paragraph of appellee's preliminary statement at page 5, or conclude that we are only questioning the legal effect of the findings of the District Judge. This is definitely not so; we question the findings themselves.

---

Appellee also suggests at this point that there is some insufficiency in appellant's specifications of error. The findings of the District Court, as prepared by appellee's counsel and entered by the court, are thirty in number and occupy fifteen typewritten pages. We are certain that this Court intends its rules to be intelligently applied and that, in this case, no useful purpose could have been served and many pages of the brief absorbed by assigning error to every possible questionable statement in the thirty separate findings. We are confident that our position is made clear to the Court by our specifications of error.

We assume that appellee is by this process attempting to gain advantage through Finding of Fact XX against which no separate specification of error was lodged by us. That finding, on which appellee relies in its brief, was as follows:

"That the tanker man and the maintenance man employed by petitioner, who were engaged in the discharging of bulk gasoline from Barge 535 immediately prior to and at the time of the accident on December 16, 1958, and who were engaged in the maintenance operations involved in the replacement of a circuit breaker in the conduit installed in the stern of Barge 535, were



competent and experienced in the duties required of them by petitioner” (Tr. 126).

In not taking specific exception to Finding XX, we deemed it simply a finding that these men were competent and experienced to perform the specific duties spelled out to them by appellee in the loading and unloading of cargo and in maintenance. Since appellee, by the undisputed evidence, never spelled out to these men what they were to do in the face of an electrical malfunction, we deemed this finding to in no way be at odds with our basic position that these men were incompetent and inexperienced as to the handling of electrical malfunctions of the sort here encountered.

Finding XX, if it is to be given the meaning which appellee seeks to ascribe to it, flies directly in the face of the admitted fact contained in the pre-trial order that “ \* \* \* the aforesaid employees of defendant, Oldfield and Bunce, did not possess sufficient skill or understanding of things electrical so as to realize that the circuit breaker switch, by so tripping, was giving notice or warning of a defective or shorted condition on the said starboard deck light circuit \* \* \*.” We cannot conceive that admitted facts can be altered by a subsequent finding. This attempt by appellee to attach certain meaning to certain language in one of the thirty findings is the very reason why we specified error to the findings as a whole, and we respectfully submit that our specifications of error, as made, have served the purpose intended by this Court in its rules.



**(b) Finding of Fact XXV.**

On pages 6 to 12 appellee attempts to support this finding as entered by the District Judge, and we will separately deal with appellee's five sub-headings at this point. First, however, we unqualifiedly say that there is absolutely nothing in the record to support this finding insofar as it relates to the precise area with which this case is concerned. It is true that appellee offered evidence as to written instructions to its employees and as to meetings with its employees in which safety considerations were discussed, but appellee's own supervisory employees, and Mr. Oldfield, all testified that there were no instructions, education or warning with respect to the circuit breakers. Mr. Oldfield testified:

“Q. Nobody had ever told you specifically, either Mr. Boyles or Mr. Williamson, or anybody else in the management of the Inland Navigation Company, had ever told you specifically what you should or should not do if this circuit breaker tripped, had they? A. No” (Tr. 186).

Mr. Williamson, the plant supervisor at Pasco, testified:

“Q. Yes, now, Mr. Williamson, I believe you already testified that you never had any discussion with Mr. Oldfield as to what he was to do when one of these circuit breakers tripped? A. Not to my recollection, a circuit breaker, what we do, no, to my recollection no. Q. Yes. Nor did you ever have any discussion with him as to this circuit breaker device being a warning system, did you. A. No. Not that I can recall. \* \* \* Q. Any of your superiors, Mr. Boyles or any of the other executives of this company that ever

discussed with you what should be done when one of these circuit breakers tripped? A. Not that I can recall. Q. Any of these executives of the company, Mr. Boyles or anybody else that ever had any discussion with you as to just what the warning function of this circuit breaker was? A. Not that I can recall" (Tr. 211-212).

Mr. Boyles testified:

"Q. Yes, now, did you ever, prior to December 16, 1958, ever issue any written instructions to these men at Pasco with respect to describing to them the function of a circuit breaker in this tripped position and what it meant in terms of warning? A. No. Q. You recognized it as a warning, didn't you, when this was in a tripped position, a warning that something was wrong? A. Yes. Q. Did you ever personally in these discussions you say you had with the men at Pasco, did you ever, personally, discuss with them, take any of them out, show them or point out to them on this circuit breaker, or discuss with them just what a circuit breaker was for and what it meant when it tripped? A. No" (Tr. 245).

Before passing to the appellee's five sub-headings, we call the Court's attention to the words "probable hazards" in Finding XXV. It needs no citation of authority that the care to be exercised in a particular situation is commensurate with the danger, and that great care is required in order to meet the legal standard of ordinary care when dealing with an explosive substance such as gasoline. We suggest that appellee had more than a duty to simply warn its employees of "probable hazards," although we would regard the re-energizing of a circuit on a gasoline barge on which

the breaker had tripped as in fact involving a probable hazard of explosion.

Under sub-heading 1, in its attempt to support Finding of Fact XXV, appellee refers to Exhibit 12, appellee's Rules and Regulations which were in use at the time of the explosion. Upon examination this Court will find that there is nothing in Exhibit 12 as to safe procedures to employ in the face of electrical malfunctions, particularly during the critical periods when gasoline is being loaded or unloaded. We are here talking about the particular area of electrical malfunction and tripping of circuit breakers, and there were no instructions on these subjects, either contained in these rules or elsewhere. It goes without saying that it matters not how careful an individual or a corporation may be in other matters, if guilty of carelessness or negligence in the particular area which caused the damage.

Under sub-heading 2, appellee points to the barge inspection reports, Exhibit 13, particularly that portion requiring the visual inspection of the electrical wiring circuits before and during unloading. This form, the Court will observe, requires no more than a visual check to see whether any fixtures or light covers are broken and, in fact, invites the tankermen to take corrective action such as resulted in the disaster here. There is certainly nothing contained in Exhibit 13 which constitutes any instructions to the employees or warning of the hazards incident to meddling with the electrical circuits before or during unloading.

Under sub-heading 3, appellee points to that portion of Exhibit 15 which reads: "If any discrepancy in the barge or the pumping of the barge, stop pumping and contact man in charge." This language is so general as to be meaningless, and in any event this instruction was being disregarded and knowingly violated when the supervisory personnel instructed Mr. Oldfield to "fix what he could" (Tr. 185, 210).

Under sub-heading 4, appellee again refers to the oral discussions and meetings in which safety and maintenance were discussed, and appellee at this point makes the absolutely incorrect statement that the maintenance man and tankermen "were to call the attention of Superintendent Williamson to *any* electrical malfunction," and the similarly incorrect statement that the maintenance man was to restrict his "activities on the electrical systems of the barges to the replacement of light globes, running cords and similar work." Both of these statements are completely unwarranted by the record which discloses without question that maintenance man Oldfield was given specific permission by both Superintendent Williamson and Supervisor Boyles to go ahead on his own with electrical malfunctions and "fix what he could" (Tr. 185, 210).

Finally, appellee's sub-heading 5 is a reiteration of the testimony as to the periodic meetings at which the general subject of safety and maintenance procedures was discussed. Appellee still does not and is unable to point to any place in the record where



the supervisory employees ever claimed to have instructed or warned the subordinate employees as to the hazards of electrical malfunctions, or what to do in the face of electrical malfunctions in general or the tripping of circuit breakers in particular. Also under this sub-heading appellee refers to the testimony of Captain House of the Washington Tug & Barge Company at Seattle. Captain House testified with respect to customary procedures in the replacement of such a circuit breaker, but a careful examination of his testimony will disclose that he was unfamiliar with the equipment here involved and that his experience related to circuit breakers and fuses on tug boats, rather than on barges where gasoline was being carried. We also suggest that if the company by whom Captain House is employed is conducting this same extra-hazardous business without giving any consideration to the ability of its tankermen to cope safely with electrical malfunctions simply because they hold tankerman certificates from the Coast Guard, then it is equally guilty of negligence and carelessness.

We have no quarrel with the cases cited by appellee on pages 9 to 12 of its brief, but each case must stand on its own feet, and none of the cases cited involve a claim of negligence based on a failure to instruct or warn subordinate employees. We respectfully submit that appellee's arguments in support of Finding XXV of the District Court, as contained on pages 6 to 12 of its brief, are without substance and that this key finding is wholly inconsistent with and un-



supported by the record, including those findings of the State Court which formed a part of the admitted facts in the pre-trial order.

**(c) Finding of Fact XXVIII.**

At pages 12 and 13 of its brief, appellee attempts to support this finding of the District Court reading as follows:

“That petitioner was not in privity with any act or failure to act of the tankermen and maintenance men employed by it which the court in Cause No. 10527 may have found to have been the proximate cause of the accident.”

This finding is the sort of catch-all language ordinarily employed by the successful attorney in drafting findings for a trial court. It includes the fallacious assumption that the State Court found the proximate cause of the explosion to have been some act or failure to act of the subordinate employees, whereas the State Court, in fact, found only that the appellee's failure to instruct and educate the subordinate employees was the proximate cause of the explosion. Otherwise this finding is in reality a conclusion of law as to the ultimate issue of whether or not appellee was in privity with the negligent causation of this explosion as determined by the State Court.

Appellee attempts to support this particular finding by again referring to the fact that maintenance man Oldfield had not reported the difficulty with the circuit breaker to any of the supervisory personnel. Appellee apparently is arguing that because the su-

pervisory personnel had no actual knowledge of the difficulty, they could not be in privity. Again this is another manifestation of appellee's "head-in-the-sand" attitude with respect to the single theory upon which this case has been prosecuted, that being *the failure of appellee's management personnel to adequately instruct and warn its employees.*

We are cognizant of the disavowal by appellee's Supervisor of Terminals, Mr. Boyles, of actual knowledge of the hazard of re-energizing a circuit on one of these barges where the breaker had tripped. This occurred at a single point in his testimony, but we submit that his overall cross-examination will demonstrate that he in fact had knowledge of the existence of the hazard of such an act. Irrespective of this, however, cases such as this are not to be defeated by such easy denials of actual knowledge. As pointed out by this Court in *States Steamship Co. v. U. S.*, 259 Fed. (2d) 458, 466,

"Within the meaning of the section of the statute limiting liability, 'knowledge means not only personal cognizance but also the means of knowledge—of which the owner or his superintendent is bound to avail himself—of contemplated loss or condition likely to produce or contribute to loss, unless appropriate means are adopted to prevent it.'"

We are also aware that at one point in his testimony appellee's expert electrical witness, Mr. Holt, characterized the chances of the triggering of an explosion in the way in which the State Court found this explosion to have been triggered, as "remotely

possible.” The causation of this explosion, as found by the State Court, is among those facts conceded by appellee to be binding and cannot be impeached by such a characterization on the part of a witness. Moreover, we suggest that the quantum of care required of one transporting gasoline must include a consideration of possible, as well as probable, sources of disastrous explosions.

**(d) Finding of Fact XXIX.**

At pages 14 to 16 of its brief, appellee attempts to support this finding, which again would appear to be more of a conclusion of law. At this point appellee deals with its evidence as to customary practices in its industry. We recognized in our opening brief, and here recognize, that evidence of custom in an industry is admissible, but again point out that such evidence is never controlling. We are certain it will not be regarded as controlling, if this Court reaches the conclusion, as we feel it should, that appellee’s failure to adequately instruct and warn its employees in this particular area was patently negligent, irrespective of any conformance to industry practices.

Also at this point appellee refers to the following observation of the District Judge during the course of the trial:

“How does he find it? Suppose he tested and never did find it, wasn’t he at fault? If it is intermittent, it is just as hard for an electrician to find it as anyone else” (Tr. 266).

The District Judge, in making this observation, was unmindful of the evidence that the use of the deck lights served by this circuit breaker was not necessary to the unloading operation but a mere convenience, and that this explosion could have been averted by a simple instruction to appellee's employees that the deck lights were not to be used during unloading if, by the tripping of a circuit breaker or by some other indication, it appeared that something might be amiss in the deck light circuit. At no time was it our position that this deck light circuit should have been tested by an electrician prior to or during the unloading for the purpose of endeavoring to find what was wrong, as that would obviously have involved a concomitant hazard. As pointed out by appellee's Superintendent, Mr. Boyles, attention to such matters is deferred until the barge has been rendered "gas free" (Tr. 249).

**(e) Finding of Fact XXX.**

At pages 16 and 17 appellee attempts to support this finding. Since it seems to be substantially the same as Finding XXV, we will rest upon what we have said as to that finding. In any event, the matter which appears in appellee's brief at this point is simply a reiteration of certain of appellee's statements with which we have already dealt.



#### 4. APPELLEE'S ANSWERS TO OUR ARGUMENTS (Appellee's Br. pp. 19-31).

##### (a) Our Contention that Privity and Knowledge Are Established by this Record as a Matter of Law.

At page 19 of its brief, appellee asserts that we are contending that the judgment of the State Court is *res adjudicata* of the limitation of liability question. We are not so contending, but we do have the right to rely upon the admitted facts contained in the pre-trial order, which included Findings III, IV and V of the State Court. We do not contend that these findings standing alone compel the conclusion that there was privity or knowledge, but we do contend that those concededly binding findings, coupled with the clear showing which was made before the District Court of a failure to specifically instruct or warn appellee's employees as to the *hazards* associated with electrical malfunctioning and proper and safe means of coping with any such malfunctioning compelled a result opposite to that reached by the District Judge. Again, we are not asserting *res adjudicata*, but we do insist that the finding of the State Court that, "the aforesaid employees of defendant, Oldfield and Bunce, did not possess sufficient skill or understanding of things electrical so as to realize that the circuit breaker switch, by so tripping, was giving notice or warning of a defective or shorted condition in the said starboard deck light circuit \* \* \*," which finding appellee, by the terms of the pre-trial order,



conceded to be binding upon it, is an established fact which is to be taken at full face value in these limitation proceedings.

**(b) Our Contention that the District Court Decision and Findings Are Clearly Erroneous as a Matter of Fact.**

While we did not, in our opening brief, refer to the United States Supreme Court case of *McAllister v. U. S.*, 348 U. S. 19, 99 L.ed. 20, we demonstrated our familiarity with its holding, where, in our opening brief, at page 39, we said,

“Be that as it may, however, we feel that this Court, on taking this case by its four corners, should be *left with a firm conviction* that appellee is not entitled to limitation of liability.”

This is our position. We recognize the legal obstacles to the overturning of factual findings of a district court, and we can only hope that a consideration of this record and what we have said will leave this Court “with the definite and firm conviction that a mistake has been committed.”

We again refer this Court to its decision in *States Steamship Co. v. U. S.*, 259 Fed. (2d) 458. The only distinction which appellee is able to draw between that case and the present situation is that in *States Steamship Co.* the court found that Supervisor Vallet had actual knowledge of the hazardous condition which caused the disaster, whereas in this case Supervisor Boyles denied actual knowledge of the hazard. This, we assert, is a distinction without a difference, for, as pointed out in *States Steamship Co.*

at page 466, "Knowledge means not only personal cognizance, but also the means of knowledge."

One further thing is relied upon by appellee at this place in its brief, that being the fact that this barge had undergone an annual inspection by the U. S. Coast Guard less than two weeks before this explosion. We respectfully direct the attention of this Court to Exhibit No. 4, being the Coast Guard Certificate relating to that inspection. This certificate incorporates the data concerning the inspection made, and clearly demonstrates that there was no attention whatsoever to the condition of the electrical systems on the barge. Rather, the inspection is wholly concerned with such matters as the sufficiency of the life-saving and fire-fighting equipment.

## 5. CONCLUSION.

Appellee has scarcely mentioned the State Court proceedings, whereas we earnestly contend that the evidence received in the District Court must be viewed in the light of and in harmony with the admitted facts contained in the pre-trial order and the binding State Court determination of liability which was necessarily based upon negligence of someone within appellee's organization. Upon so viewing the record, we are confident that this Court will be "left with a

firm conviction" that a mistake has occurred and that the District Court decree should be reversed.

Respectfully submitted,

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### CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JEROME WILLIAMS

*Proctor*

















